Securities Market Agency

POSITION OF ATVP ON ICO CONSULTATION PAPER

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Contents

THE LIST OF TERMS AND ABBREVIATIONS

AIFMD	Alternative Investment Fund Managers Directive
AIS	Alternative Investment Funds
BCH	Bitcoin Cash
BLOCKCHAIN	Blockdata transmission chain
BTC	Bitcoin
CRYPTO CURRENCIES	Digital currencies
CRYPTO ASSETS	Digital assets
DVP	Delivery Versus Payment
ESMA	European Securities and Markets Authority
ETH	Ethereum platform or currency
FIAT MONEY	Currency without intrinsic value (regulated value currency)
ICO	Initial Coin Offering
OZ	Obligation Code of the Republic of Slovenia
SMART CONTRACT	A computer protocol intended to digitally facilitate performance of a contract
SANDBOX	Virtual space in which untested software or coding can be run securely
SECURITY TOKENS	Security tokens
TERMS AND CONDITIONS	Terms and conditions
UCITS	Undertakings for Collective Investment in Transferable Securities
UTILITY TOKENS	Also called user tokens or app coins, enable access to a company's product or service
WHITE PAPER	Presentation document
XRP	A payment network (RippleNet) and a cryptocurrency (Ripple XRP)
ZISDU-3	Investment Funds and Management Companies Act
ZNVP-1	Book-Entry Securities Act
ZPPDFT-1	Money Laundering and Terrorist Financing Act
ZTFI	Markets in Financial Instruments Act
ZUAIS	Alternative Investment Fund Managers Act

1. INTRODUCTION

Securities Market Agency (ATVP) has published Consultation Paper with the aim of obtaining opinions from the widest possible circle of interested publics, and on the basis of information gathered in this manner, to define the starting points which it will represent before domestic (including legislators) and European institutions (ESMA, European Securities and Markets Authority).

ATVP has published Consultation Paper on its website and directly informed some of the key stakeholders thereof. ATVP has received responses from:

- two legal offices;
- a token issuer;
- a group of students of the Faculty of Law
- a venture capital company.

The Paper presents ATVP's position on the interpretation of existing legislation as well as its position on possible changes in ATVP's area of competence. The changes in legislation would require the effectuation by the legislature. In this Paper, ATVP also considers some other provisions of the laws which do not directly fall under the competence of ATVP, so they would consequently require, according to ATVP, the adjustment to new realities and technological development, or otherwise, in the absence of a comprehensive approach to the regulation of crypto-assets, the development of the sector could encounter new obstacles.

2. BLOCKCHAIN TECHNOLOGY

The term blockchain technology encompasses computer programs that enable between dispersed and usually anonymous participants of the decentralized and autonomous system, the unique, verified, verifiable, accessible to all participants and backward, fixed archives of records of a certain fact are created. Such a single record represents a data block, and the entire record archive is a blockchain.

The dominant product of the distributed ledger technology is token. Tokens are on a computer network and in accordance with the rules of this network the resulting fact (a record of the distributed ledger). Tokens may have their issuer (tokens issued under the ICO procedure always have their issuer), or they may not (BTC).

As a fact that is written in the blockchain technology the so-called Smart Contract can also be created. A Smart Contract is a digital record of the computer code (program). As such, it does not necessarily constitute contracts in the legal sense of the word.

3. RISKS TO WHICH AN ICO INVESTOR IS EXPOSED

ATVP points out that the investment in ICO-based tokens is associated with large and partly not yet fully identifiable risks. Potential investors should pay particular attention to the following risks:

3.1. Lack of legislative regulation

ICOs in many countries (including Slovenia) are currently not systemically regulated and supervised. As a result, investors in these schemes do not have any assurances similar to those that apply to the initial offers of securities on regulated financial markets. Similarly, ICOs originating from the other Member States or third countries of which tokens are available for purchase also to Slovene investors are unlikely to be regulated in their home country.

Some ICOs can be used for fraudulent or unauthorized activities, with some recent ICOs being defined as fraudulent.[1] It cannot be excluded that some ICOs are used for money laundering purposes. In the event that the legislation and regulations of the Republic of Slovenia or the EU do not apply to the ICO, investors cannot be protected by these regulations.

3.2. Lack of credible information

Information available to investors, e.g. in offering documents, are in most cases unaudited, incomplete, unbalanced or even misleading. Usually, the focus is on potential benefits, while risks are presented only briefly. The documentation is often technical and is not easily understood by the common investor. Consequently, investors cannot understand the risks they are accepting, so the investment often does not meet their needs. The documentation often does not indicate the names of the responsible persons and does not define the jurisdiction in the event of a dispute. In any case, this documentation does not equate the documentation that needs to be prepared and published in the case of a public offering of securities. The latter requires, inter alia, the prior approval of a competent independent institution.

3.3. High risk of loss of funds invested

ICOs are generally intended to finance projects at their very early stages. Such investments have, by their very nature, a high risk of failure. Many tokens that have been issued do not have any intrinsic value, except for the possibility that the holders use them to access the service or product that the issuer should develop. Project plans that are subject to ICO are generally not reviewed or verified by independent experts and often also contain a number of assumptions and financial forecasts that may prove to be too optimistic, inaccurate or incorrect. Last but not least, there is no guarantee that these projects will be completed or can be implemented at all.

3.4. Price volatility and low liquidity

Since tokens usually do not represent the right to either ownership or debt, the investor actually invests in the project and not in the issuer. This means that the future value of the token depends only on the actual future prevalence of the use of each token and the ability of its issuer to implement the project. The value of the token is thus not necessarily related to the financial stability and the entire business operation of the issuer.

The value of tokens is extremely volatile and subject to significant and predominantly unpredictable fluctuations. There is a high probability that the secondary market does not develop for the tokens, so investors with their tokens will not be able to trade or replace them for traditional currencies such as the euro. The activity of trading tokens is unregulated. It is therefore not subject to the transparency rules and the rules on the prohibition of market abuse. Thus, the markets on which tokens are traded do not offer the same assurances that are commonly used in conventional financial markets.

[1] See e.g.: https://www.ssb.texas.gov/news-publications/4-billion-crypto-promoter-ordered-halt-fraudulent-sales (8. 1. 2018) or: https://www.sec.gov/news/press-release/2018-53 (8. 6. 2018) – the tokens issued under the latter ICO are listed, for example, at the famous Binance exchange

4. APPLICABLE LAW AND ICO

As a new form of financing, the ICO is just entering the economic area. The existing legislative framework is thus not adapted to the ICO, as it was not yet envisaged at the time of its creation.

Currently, each ICO is considered or judged individually in order to determine whether it interferes with any of the areas regulated (as presented below), and indirectly also with the intention of determining whether legislative adjustments are necessary for the protection of investors.

Whether a token represents a financial instrument depends on its content. The ZTFI defines financial instruments in Article 7 as follows: (i) transferable securities, (ii) money-market instruments, (iii) units in collective investment undertakings, and (iv) derivatives. The classification of tokens, as one of the financial instruments, would result in the application of the entire set of provisions of the ZTFI transferred from MiFID. In addition, legislation on individual types of financial instruments includes additional requirements – e.g. for transferable securities, the liabilities arising from the provisions on the first public offering, for units in collective investment undertakings, the liabilities arising from the provisions of the laws transferred from the UCITS and AIFM directives. In the following, the ATVP determines the issues relating to individual categories of financial instruments. Further in the text, ATVP determines the questions related to individual categories of financial instruments.

At this point, however, ATVP would like to warn of the risk that the placement of tokens only through the interpretation of financial instruments (in particular, this applies to transferable securities), would consequently mean an obligatory use of a wide set of rules that would very likely disable the operations of ICO issuers.

4.1. Are tokens issued in an ICO a transferable security document?

Transferable securities are defined in the third paragraph of Article 7 of the ZTFI. Transferable securities are all types of securities other than payment instruments that can be traded on capital markets. Consequently, a token is a transferable security only if it is previously defined as a security.

The security is defined in the Slovenian law in the Obligation Code (Official Gazette of the The Republic of Slovenia, No. 97/07 - official consolidated text and 64/16 – constitutional court revision), which provides that a security is only a record of a debt or liability that is issued as a written document or in the manner prescribed by another law.

In its Consultation Paper of January 2018, ATVP stated that tokens may contain a record of the holder's rights and obligations. This does not reflect the actual situation. The tokens currently known to ATVP (BTC, BCH, ETH, XRP, and some tokens issued on the Ethereum[2] platform) contain neither a record of the holder's rights nor the token issuer's statement. Also, the aforementioned is usually not contained in the Smart Contract based on which tokens were created (in case they were created on the basis of a Smart Contract).

The definition of the holder's rights is usually found in the documentation which accompanies

[2] The tokens can be issued also on the platforms: Neo, Waves, Omni, Bitshares, Stellar, Counterparty, Qtum, Ubiq, Ardor

the issuance of tokens. The issuer's statement is *usually given only through the indication of issuer's public address on the platform* on which the tokens are issued. The token is transferable. The tokens can have their own value which derives from the value of the rights they represent, or when they do not provide the rights, their value is derived from the relationship between demand and supply. In this respect, even if the formal requirements are withdrawn from the Slovenian legislation, the tokens cannot qualify as transferable securities due to the lack of at least two essential components of securities (obligations and the issuer). Thus, the ICO does not fall within the scope of the stated legislation, and as such cannot represent the public offer of (transferable) securities to the public.

4.2. ICO and regulation of collective investment undertakings

In accordance with the definition of the Investment Funds and Management Companies Act (Official Gazette of the Republic of Slovenia, Nos. 31/15, 81/15 and 77/16, hereinafter: ZISDU-3), the investment fund is a collective investment undertaking, the sole purpose of which is to raise funds from investors and, in accordance with a predefined investment policy, invest in different types of investments for the sole benefit of the holders of the units of this investment fund.

In terms of their characteristics, the investment funds are divided into undertakings for collective investment in transferable securities (UCITS) and alternative investment funds.
The key elements in the light of which ATVP assesses whether the undertaking could be an investment fund are:

- the absence of a general commercial or industrial purpose,
- raising funds from investors for the purpose of investing these assets in order to ensure the investors a pooled return;
- investing of funds in accordance with a pre-defined investment policy and
- owners of units as a group do not have day-to-day discretion or control.

In addition to ZISDU-3, this area is regulated by the Act on Alternative Investment Fund Managers (ZUAIS).

4.2.1. Undertakings for collective investments in transferable securities (UCITS)

UCITS is an open-end investment fund that raises funds from the public, and of which the sole purpose is to invest in securities and other liquid financial investments according to the principles of risk spreading. In Slovenia, UCITS funds are established as mutual funds or as umbrella funds with several sub-funds. In order to protect retail investors, the operations of UCITS funds are strictly regulated (ZISDU-3) and are subject to the supervision of ATVP. (So far) ICOs were generally not issued for the purpose of collective investment in liquid financial investments, but were primarily intended to raise funds for the implementation of certain business projects. The usefulness of issuing units of UCITS in the form of a token is limited by the fact that investment coupons representing units of UCITS in the Republic of Slovenia are non-transferable, and that in the case of the issue of transferable investment coupons those are subject of an obligation to be issued in the form of a dematerialized security.

4.2.2. Alternative Investment Funds (AIFs)

Alternative Investment Funds (AIS) are all other investment funds that are not classified as UCITS. Unlike UCITS, the AIF's investment policy is not limited to securities, but rather can these funds be invested in different types of investments, and units are offered publicly or limited to a particular group of potential investors.

(So far) ICOs were presented as raising of funds aimed at financing projects, and the purpose of issuing tokens was not to create a pooled return for investors. However, according to recent

developments in the market, it is not possible to exclude the possibility that some types of ICO could be considered as AIFs.
Since the legislation does not impose a defined form in the case of AIS units, the recording medium of the unit is irrelevant (regardless of its transferability). Thus, a token could be regarded as a unit, insofar as the payment would entail support for a project that fulfils the conditions for an investment fund as defined by the legislation and listed above.

For the AIF, it is considered that they can only be marketed to professional investors as defined in Article 31 of the Act on Alternative Investment Funds (Official Gazette of the Republic of Slovenia, No. 32/15, hereinafter: ZUAIS), and only when the local law allows it, under special conditions, to non-professional investors as well. The marketing of AIF to non-professional investors applies only to the territory of the relevant Member State and can not be the subject of the notification process.

It is also considered that the manager, in order to provide AIS management services (including the marketing of AISs) throughout the EU, must obtain ATVP authorization under ZUAIS and carry out the notification process in the relevant Member States.

4.3. Are tokens issued under the ICO procedure a financial instrument or a money market instrument?

Regarding the question whether a token may be recognized as a money market or a derivative financial instrument, it is considered that the definition is not dependent on the medium on which it is issued, or on the question whether it contains the components which the Obligation Code requires for the security. The definition depends only on its content. Consequently, a token that has no content could not by itself be a derivative of a derivative financial instrument or a money market instrument. The tokens that function as part of a Smart Contract, that determines their content, can be recognized as a money market instrument or a derivative.

Depending on its content, a Smart Contract by itself could be recognized as a derivative because for derivative financial instruments transferability is not required.

4.4. What does it mean in the context of the classification of tokens into investment, utility and cryptocurrencies?

Initially, the ATVP wants to point out that the classification of tokens by categories is always arbitrary and that each token is subject to individual judgment, so they can be given the same name although they might be subject to different criteria. Regardless of this, in the crypto world, the currencies have been classified as investment, utility and cryptocurrencies.

The basis for classification are the rights which token grants to its holder.[3] Thus, investment tokens are the tokens which either grant or promise to their holder the rights comparable to the rights which financial instruments grant to the financial instrument holder:

- in the case of securities: debt securities, voting rights[4], right to profit;
- in the case of collective investment undertakings: the right to a fictitious share in jointly managed assets;
- in the case of derivatives: a right to cash payment.

Utility tokens provide access to a service, where the service is available at the time of the tokens issue in a known amount of tokens, or (more often) later, in an unknown amount of

[3] Regardless of whether they are incorporated in the token or only recorded in the token issuance documentation.

[4] Voting rights must relate to contents that according to the law represent the exercise of shareholder rights. The voting right regarding the company management with unrelated content cannot be the basis for the classification of the token in the mentioned category.

tokens. Usually, tokens issued by a known issuer are classified as utility tokens, because in the future he may offer some services in exchange for the tokens. Utility tokens are usually issued on a token issuance platform (Neo, Waves, Omni, Bitshares, Stellar, Counterparty, Qtum, Ubiq, Ardor, etc.).

The cryptocurrencies are usually considered the tokens which:

- have an anonymous issuer or person who looks after the platform and whose purpose is to use tokens as a means of payment (BTC, BCH); or
- have an issuer or person who looks after the platform (ETH,[5] XRP) and whose purpose is to use tokens as a means of payment (at least as a payment for the platform services).

Currently, the subject of the regulation, in the frame of the existing legislation, are only the tokens that, based on their content, can be classified either as collective investment undertakings or derivative financial instruments. The tokens which could, according to their content or economic purpose, represent (transferable) security do not fall under the existing legislation. These tokens do not meet the requirements of the Obligation Code since they lack the required form and essential components.

5. ATVP DEFINITIONS REGARDING THE PUBLIC CONSULTATIONS ISSUES

5.1. Self-regulations, existing regulations or new regulations

The common position of all participants in the Consultation, which ATVP fully agrees with, is that self-regulation lies outside the competence of ATVP, the legislators and/or any other state authority. According to ATVP, self-regulation must remain in the domain of the market participants themselves, so the legislators do not have and cannot play a role in directing or validating the content, or influence the content of self-regulation. In the absence of regulation, self-regulation plays a role that significantly directs the activities, and in the existing regulatory system, self-regulation can be an important factor in upgrading the content. ATVP points out that it is questionable whether self-regulation alone can provide adequate protection for investors. Self-regulation does not establish legally binding rules, and its violation is also not sanctioned by state authorities.

A large number of the questions and responses was intended to obtain opinions on the applicability of the existing legislation to the emergence of ICOs and to raise the question of possible adjustments regarding the establishment of a new legal framework. ATVP especially wishes to make it clear that its operation is limited and determined by the law. The applicability of the existing legislation to tokens is possible only through the interpretation of existing legal documents. The new legal framework falls under the jurisdiction of the legislator; ATVP can only represent certain positions in this respect and propose individual solutions to the legislator.

Legislation in the area of the ATVP, which defines its competencies and operations, can be found at http://www.a-tvp.si/Default.aspx?id=25.

The ATVP is financed from fees and charges paid by participants in the financial instruments market over which the ATVP exercises supervision and grants licenses for their business activities. The current attractiveness of ICO lies to a significant extent in the simplification and lower costs of conventional securities transactions. Market stakeholders must be aware that the external supervision comparable to the supervision exercised by ATVP over the other stakeholders, will, in addition to investor safety, also increase the costs of issuance and transactions. According to ATVP, the latter is not and cannot be the reason for not introducing

[5] ETH is under the responsibility of Ethereum Foundation - https://www.ethereum.org/foundation

the regulation and supervision, so public awareness is needed that supervision over the mentioned entities cannot be indirectly financed from the fees paid to ATVP by the entities who are not involved in ICO operations. By introducing supervision, in addition to increasing safety and transparency of operations, the operating costs of currently unregulated entities will necessarily also increase.

In addition, the sandbox issue should also be addressed. The sandbox, as an instrument of the supervisor, facilitates the operation of technologically innovative companies and it appears on the European territory in several different forms. This is the case with sandboxes for the provision of testing space in the supervisor's environment, with or without regulatory exemptions or allowances. According to ATVP, the sandbox, as a legally defined framework, makes sense only when the regulator has tools in its hands, which enable him during the testing to apply the legislation in a different way, as is the case with other operators on the market. Currently, the law does not allow ATVP such an approach, because it does not give it enough broad powers. While ATVP monitors and welcomes the practices of sandboxes introduced by some other European regulators, in the event of any changes in legislation that would increase the competence of ATVP and its discretion right in applying the legislation to an individual entity in this respect, account should be also taken of the resources currently available to the ATVP. Operation within the sandbox requires an enduring and professional involvement of the regulator's resources, which significantly exceeds the current capacity of ATVP. Therefore, the financing of such operations cannot be indirectly covered by other market participants, which have neither any benefit from this function of ATVP nor any interest in it.

Under the existing legislation, ATVP can treat entities only when applying the rules of proportionality to the extent and in the manner allowed by the law. With limited resources and the existing legislative constraints, ATVP considers the institutionalization of the sandbox not to be absolutely necessary, but that certain measures of enhanced cooperation in the phases prior to the obtaining of licenses before ATVP are reasonable, and that they clearly provide the competence of the ATVP over the entity and the purpose of cooperation – issuance of the licence.

Regarding regulation, it is also necessary to address the question of the appropriateness of the local legislation in the cases that go beyond the Slovenian jurisdiction and have expressly cross-border character. From the sole analysis of the answers regarding jurisdiction and competence, it is not possible to derive a simple answer – and as the answers in relation to the competent supervisory authority most frequently offer the solution of applying the jurisdiction of the issuer, (where an additional challenge are the groups of physical persons of different citizenships, who are not registered as a legal entity with an identifiable head office) the question of choice of law or of applicable law, represents an entirely new challenge. At this point, ATVP would like to point out that local legislation can only regulate the rules of operations in the territory of the Republic of Slovenia. In the absence of harmonized European legislation, none of the solutions adopted exclusively within the Republic of Slovenia would enable the operation of companies in the whole territory of the EU.

Regardless of the positions presented in this Document, the European Institutions (ESMA, European Commission) may give different interpretations or regulate the area in the manner other than that proposed by ATVP in this Document. ATVP will, in any case, follow the binding Acts of the European institutions and regularly inform the interested public about the positions of the European institutions when they are publicly available.

5.2. The future crypto-assets regulations

Regarding the possible future regulations of the crypto-assets and on the basis of the opinions presented in the Consultation Document, ATVP gives the following opinion.

Crypto-assets are divided into two groups. In the first group belong the crypto-assets that have an anonymous issuer, do not provide their holders with any rights and whose value arises only from supply and demand. These crypto-assets usually represent units of cryptocurrencies (e.g. BTC, BCH). In the second group belong the crypto-assets that have a known issuer. The first subgroup of the crypto-assets having a known issuer represents crypto-assets that do not provide their holder with any rights and are used as a conversion tool on the issuer's platform. They are, for example, WAN, EOS, XRP. Such crypto-assets are often referred to as cryptocurrencies. The second subgroup of the crypto-assets having a known issuer represents crypto-assets that provide their holders with certain rights. These crypto-assets usually show the right to exchange the crypto-assets for the issuer's services; such crypto-assets are, for example, TRON, IPL. The term “utility tokens” is usually used for this type of crypto-assets. The crypto-assets having a known issuer and showing certain ownership rights may also provide their holders with the ownership of some of the rights comparable to the rights incorporated in the securities (right to profit, voting rights, debt securities). In this case, they are called “investment tokens”.

It would be appropriate for the new regulation to be based on the principle of technological neutrality. Therefore, the crypto-assets having a real (economic) nature, similar to the financial instruments, are to be treated similarly to financial instruments. On the other hand, those which are not of such nature should be treated differently.

While due to some rights, which are clearly defined by the legislation, the investment tokens are relatively easy to classify as financial-like instruments, the matter with the utility tokens is somewhat more complex. Regarding the utility tokens, ATVP points out that at the time of purchase of such tokens their holder does not know how many of them will actually be required to pay for the service of the issuer. Usually, at the time of purchase of the utility tokens, neither the price of the service that is supposed to be paid in the future with the tokens, nor the value of the utility token at the time of the purchase of the service is known. It means that the holder of such tokens, by purchasing them, assumes the risk that the value of his assets may be reduced in the future. The holder must be aware of the existence of an investment risk, the amount of which depends to a large extent on the success of the performance of the issuer's project. Investment risk is one of the basic characteristics of equity securities. The same characteristic when the value depends to a large extent on the issuer's business operations can be recognized in all crypto-assets having a known issuer.

As a consequence, if we would like to prevent regulatory arbitrage between products with the same aim of the issuer (to collect the money of investors) and the same interests of the holder (good business operation of the issuer, higher value of the issued instrument), both investment and utility tokens should be treated according to the same principles as securities. In this regard, ATVP points out that the existing legal framework provides an appropriate theoretical starting point for dealing with the crypto-assets, but does not necessarily contain appropriate responses to all issues regarding crypto-assets.

More precisely, some individual issues, which in the opinion of ATVP require tailor-made solutions, are presented in the following chapters.

5.3. The rights and changes in the rights attaching to crypto-assets

Regarding the content of rights and obligations that tokens may involve, ATVP points out that in the Republic of Slovenia the principle of free regulation of obligational relationships is in

force. Accordingly, the content of obligational relationships is limited only by the Constitution, forced regulations and moral principles. This is also true regarding the securities. Neither Obligation Code (OZ) nor Book-Entry Securities Act (ZNVP-1) limits the content of the obligational relationships that is incorporated in the security. Today we also do not know what the standardized content of the crypto-assets could be. We, therefore, consider that in the initial period of standardization of crypto-assets it is appropriate to maintain this approach.

If the principle of technological neutrality is followed, changes in the rights held by crypto-assets holders should be admissible under the same conditions as the changes in rights attaching to securities. They should be admissible only on condition that the possibility of their change and the decision-making process regarding them is known to the holders in advance. The same thing should apply to the crypto-assets.

In respect of the possibility to modify the platform (blockchain), it is considered that a change which would be only of technical nature and would not affect the rights of the holders should be allowed without the consent of the holders. But such a case is unlikely to occur. Changing the platform would most likely require changes in the infrastructure used by the holders – e.g. crypto wallets. Such a change would likely make the holding of crypto-assets more difficult and any such difficulty attaching to the holding would impinge on the rights of the holders. The change should be allowed and performed in the manner in which the rights held by the holders are changed.

5.4. Initial Coin Offering

The ATVP considers that the investors should be given the most detailed and credible information regarding each issuance of tokens. Token issuers are already preparing a sort of offering document (with explicit or implicit terms of issuance), which more or less accurately gives information about token issuance conditions. These are the so-called white papers and terms and conditions are published by the issuers on the Internet. The content of the existing documents is not legally regulated.

Whether or not it is necessary to legally regulate an individual issuance of tokens, and consequently, whether or not it is necessary to prepare a legally prescribed offering document for a particular issuance of tokens, depends according to the ATVP on the type of token that is being issued.

Regarding the issuance of the tokens that could be considered as a security (depending on the content or economic similarity, i.e. both investment and utility tokens), ATVP advocates the preparation of a legally prescribed offering document that follows the principles laid down in the Prospectus Directive and Regulation. The information contained in such offering document should be correct and complete and presented in such a way that the offering document is transparent and comprehensible to the potential investor. The offering document should also clearly indicate the responsibility for the content of the offering document, so the offering document should contain information on all persons responsible for the correctness and completeness of the information contained in the offering document. In relation to the persons responsible for the content of the offer document, the offering document should contain the information on the basis of which the responsible persons can be clearly identified and the declaration by each of these persons that, to the best of their knowledge, the information contained in the Prospectus is in accordance with true facts and that no information has been omitted from the offering document which could affect the significance of the offering document.

Responsible persons could also be liable to the investor for damage caused to him by incorrect or incomplete information contained in the offering document.

The prescribed format and content of the offering document should also take into account the specificity of the token issuers, while the legally prescribed offering document (in comparison

with the existing presentation documents) should be more detailed and more specific in presenting the project itself, as well as the process of issuing tokens and the necessary collected funds. It is recommended that the content of the offering document be standardized at the EU level, in order to ensure comparability of information at the EU level.

Additionally, the content of the legally prescribed offering document could be (optionally) reviewed/approved by independent experts (e.g. auditors), depending on the request of the token issuer. The review/approval of the content of the legally prescribed offering document by independent experts (auditors) would therefore not be mandatory, but it would be obligatory to disclose whether such a review (audit) was actually carried out and, if so, to what extent. The issuer should also, if necessary, keep the offering document updated on its own initiative.

Regarding the approval of the offering document, ATVP considers that it would be necessary to follow a system that would be, with regard to offering documents for the issuance of tokens, adopted at the EU level.

In determining the amount of the collected funds (in crypto-assets or fiat currency) by issuing tokens, ATVP takes the view that the upper limit of the collected funds cannot be determined by the law, and that it should be determined by the issuer of the tokens who, in addition to the upper limit shall determine the lower limit as well, which will increase the transparency of the project. If the issuer does not determine the upper limit of the collected funds in advance, it should, in the opinion of the Agency, be justified in the offering document.

Regarding the real-time informing of investors about the amount of the collected project funds, ATVP agrees with the majority opinion of the participants in the Consultation Document that such real-time information is not necessary for the investors, and that it would be appropriate for the issuer of the tokens to inform investors about the collected amount of funds after the end of the project.

ATVP considers that the initial value of the token may be determined exclusively by the issuer and that it is reasonable at the pre-ICO stage to sell tokens at a price lower than the initial price published at the time of publication of the offering document. The pre-ICO stage, the purpose of which is to raise funds for the start-up of the ICO itself, presents a greater risk than the ICO itself. The fact that the pre-ICO price is lower than that of the ICO sales stage should also be clearly disclosed in the offering document.

ATVP considers that for the time being there is no need to regulate the payment of profits to the holders of tokens, but that in the future it will be necessary to consider this topic, taking into account the development of tokens.

5.5. Places to trade cryptocurrencies

Currently, cryptocurrency trading sites are divided into two categories. In the first category, the cryptocurrencies of users are stored on the trading sites accounts, where the transactions are performed within the accounts held by the trading site. In this case, they are called Custodial Exchanges. Their main characteristic is that in the blockchain it is the Exchange that is registered as the holder of the assets, not the account holder. So, the Exchange functions as a place of deposit of assets on behalf of clients. Due to the fact that the Custodial Exchange performs transactions through accounts held by the same holder, in such Exchanges, the assets issued in different blockchains including fiat currencies can be traded. Custodial Exchanges operate on the basis of DvP (Delivery versus Payment), a common form of settlement for securities.
The settlement is virtual because the balance on the sub-accounts managed by the deposit site is really changed by the DVP, and the actual person trading the assets becomes the holder of the assets only when he transfers the assets from the Custodial Exchange account to his account, or when such transaction has been recorded in the blockchain.

The second category is represented by (so-called) Decentralized Cryptocurrency Exchanges. Their main characteristic is that trades occur directly between users (peer to peer). Therefore, Decentralized Cryptocurrency Exchange does not provide funds storing services. Transactions are performed based on Smart Contracts. It is exactly the use of Smart Contracts that requires Decentralized Cryptocurrency Exchanges to allow only the transactions performed with assets issued in a single blockchain. Thus, in Decentralized Cryptocurrency Exchanges clients can trade, for example, only with cryptocurrency issued on the Ethereum platform, which means that in Decentralized Cryptocurrency Exchanges you cannot trade, for example, with BTC versus ETH or XRP, neither with the Fiat currencies.

In terms of the regulation of cryptocurrency exchanges, ATVP believes that, taking into account the above mentioned principle of technological neutrality, they should be regulated, and that their regulation should be based on the principles applicable to the trading sites of financial instruments, such as, for example, the principle of the reliability of the trading system, simultaneity of settlement, non-discriminatory rules of execution of orders, transparency of supply and demand, and transparency of concluded transactions. The regulations should be applicable both to Custodial Exchanges and Decentralized Cryptocurrency Exchanges since the mere fact that a trading site is established as a Decentralized Cryptocurrency Exchanges does not mean that such trading site has no manager or person appointed responsible for the correctness of trading. Regarding Custodial Exchanges, it would also be necessary to regulate the rights and obligations that would, concerning cryptocurrency exchanges, arise from their custody over clients' tokens.

Today cryptocurrency exchanges decide on the listing of a particular cryptocurrency by themselves. Thus, a cryptocurrency is listed in a cryptocurrency exchange regardless of the issuers' wishing. The current practices may become questionable if the quotation of the cryptocurrencies in cryptocurrency exchanges imposes new obligations on the issuer.

5.6. Information asymmetry between issuers and holders of tokens and the integrity of the market

The Slovenian (and European) regulation contains a number of rules that aim to reduce the information asymmetry among the holders of securities (majority shareholders, minority shareholders, shareholders who are also members of the management, etc.), as well as among holders of securities and their potential new buyers. The rules that reduce the above-mentioned asymmetry are contained in the Markets in Financial Instruments Act (ZTFI), in the chapter on the disclosure of regulated information, and to some extent in the Market Abuse Regulation. Furthermore, in order to provide correct information to all stakeholders, public companies, according to the Companies Act (ZGD-1), are considered to be public interest entities. In accordance with all the above mentioned Acts, issuers of securities have to publish audited financial statements, their annual reports must contain certain disclosures, and shareholders of public companies must keep the issuer informed of significant shares.

Additionally, the ZGD-1 rules reduce information asymmetry between holders of securities and members of management, or the management and supervisory bodies of the company, and between minority and majority shareholders. ZGD-1 achieves this by imposing the obligation of public announcements of corporate legal affairs (e.g. convening a general meeting, appointing the management members) and numerous rights of minority shareholders.[6] Thus, ZGD-1 provides all shareholders with access to real and up-to-date information about the status of the company and the adopted business decisions.

Holders of tokens are not shareholders. It means that even if they have the interest, same as the shareholders do and as mentioned above, that the issuer adopts business decisions to their benefit, unlike shareholders, they have no rules that would enable them to be at least

[6] See above.: http://www.mgrt.gov.si/fileadmin/mgrt.gov.si/pageuploads/SOJ/ZGD_dolocila_151110.doc (8. 2018)

familiar with the issuer's decisions. Even less, they have the ability to control or influence the issuer's operations.

Also, in relation to tokens, the rules on market abuse do not apply. Currently, neither insider trading (which is a direct consequence of information asymmetry) nor market manipulation is banned.
Accordingly, ATVP points out that if we wish to have the information asymmetry in the distributed ledger technology reduced, it would be necessary to introduce the above-mentioned rules into the cryptocurrency world.

5.7. The target group of investors

The existing ICOs urge all investors, irrespective of their knowledge, assets and other factors that are taken into account when investing in financial instruments (transferable securities and units of collective investment undertakings). While the existing legislation protects investors, who invest in regulated financial instruments, during the sale process as well as at later stages, the ICO process is completely unregulated, which in terms of technological neutrality brings disproportion to the investment area particularly to non-professional investors.

If we follow the principle of technological neutrality, in order to protect investors in the tokens which are similar to financial instruments, it is logical that the same rules which protect investors in financial instruments should apply. Thus, for example, investment companies when they sell financial instruments to investors, should perform an eligibility test (to find out if the investor understands the financial instrument), and also provide investment consulting or asset management services, as well as an adequacy test (to find out if the financial instrument is appropriate for the investment needs and the type of the investor). If the investment company determines that a certain product is not suitable for a specific investor, it may still sell it to the investor, but must warn the investor of the inappropriateness. Similarly, for each investment product they offer, investment companies must identify the relevant target group, and if they find that a specific target group is no longer eligible, they must stop selling the product to this target group.

ATVP considers that for the ICO in relation to the target group of investors, "safeguards" should be established by legal regulations, which would enable or require the investor to know what risks he is exposed to and how these risks could be constrained. Taking into account the specific features of both the product itself and the technology on which ICO is based, ATVP proposes two possible solutions, namely:

1. setting up the maximum investment limit for an individual investor: the possibility of reducing the risks for an individual non-professional investor implies the introduction of an investment ceiling. This is a contrary regulation, comparing to the one existing in the law governing alternative investment fund managers, where a floor investment is set up for an investor to be granted the status of a professional investor. In this way, it would be possible for non-professional investors to avoid too high exposure to a particular project, and consequently reduce their risk. The amount limit would apply only to non-professional investors, while the so-called qualified investors (the investor group which would include, for example, individuals participating in the ICO or professional investors) would be allowed to invest a larger amount of funds;

2. the regulation originating from the *Proposal for a Regulation of the European Parliament and of the Council on European Crowdfunding Service Providers (ECSP) for Business*: given that ICO procedures often include elements of crowdfunding, it would be meaningful to adopt the model or adjust the regulation from Article 15 of the above-mentioned Proposal for a Regulation.

3. investor to carry out a simulation of the acceptable amount of the loss of invested assets in relation to his assets. In the initial assessment of the suitability of an investment for a potential

investor, the ICO issuer must collect information about the basic knowledge of the possible investor and his understanding of the risks of investing both in traditional forms of investment and in the crypto-assets. By simulating the acceptable amount of the loss of invested funds, the ICO issuer would make it possible for both potential and existing investors to calculate what amount of loss is acceptable to them with regard to their assets. However, regardless of whether the initial assessment of the suitability of the investment for a potential investor or the simulation of an acceptable amount of loss of investment has shown that an investment in ICO is not suitable for the (potential) investor, the ICO issuer would not reject the investor, but only warn him about the risks he is going to expose himself to.

5.8. Collective Investment Undertakings

Respecting the principle of technological neutrality, there remain some key elements in terms of which ATVP assesses whether or not a particular undertaking could be an investment fund, irrespective of the type of assets which the investment undertaking invests. The key elements of an investment fund are defined in point 4.2 of this Document.

Since the legislation in the case of alternative investment funds units[7] does not impose the specific form of the unit, the recording medium of the unit is irrelevant (irrespective of transferability). Thus, the token could be regarded as a unit, insofar as the payment would entail support to a project that fulfils the conditions for an investment fund as defined by the legislation and listed above.

Regarding the characteristics that have emerged in the market of collective investment of funds in crypto investments, in terms of technology neutrality the relevant regulation is the one applicable to an alternative investment fund manager, authorized by the competent authority and the fund he manages. Such a decision is based on the fact that in the management of such undertakings, investors' funds are collected in different countries, that is, they have an element of cross-border provision of services.

The rules applicable to an alternative investment fund manager and to the funds he manages are determined by the Alternative Investment Fund Managers Act (ZUAIS), where the provisions of the European Directive on AIFMD[8] have been implemented. These are primarily rules relating to the operation of the manager himself (capital assets, rules of operation, organizational requirements) as well as to the management and operation of the funds themselves (transparency of operations, obligation to appoint a custodian, accession to the fund).

However, according to ATVP, due to the characteristics of the ICO and the specificity of the crypto-assets, certain rules will have to be adjusted.

In the first place, according to ATVP, it is necessary to adjust the rules on the custodian and the provision of custody services, which include assets custody services as well as the services of supervision over the AIF operations. From this point of view, ATVP believes that it would be necessary to:

- expand the range of people who can provide custody services, given that a completely new form of investment is concerned, for which the existing custodians are not capable or willing to offer custody services;
- determine what kind of asset custody can be performed for crypto-assets. The existing regulations assume that financial instruments are those that can be recorded in a separate account opened with the custodian and the financial instruments issued as written documents in custody with the custodian who is liable for damages in case they

[7] An investment fund that invests its assets into cryptocurrencies in accordance with legislation belongs to alternative investment funds.

[8] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

are lost. Regarding all other assets, the custodian checks whether they are owned by the Fund and regularly keeps and updates the records. According to ATVP, in the case of crypto-assets, custody, as currently defined by the ZUAIS, would not be possible (it could also be unnecessary due to the nature of the technology) and the custodian could perform an overview of ownership and establish and keep records of the assets.

Another important point concerns the approach to non-professional investors. As has already been found in ICO procedures, such products are intended for sale to non-professional investors. The current provisions in ZUAIS have been adjusted to the fact that investors in alternative investment funds are professional investors. In this part, ATVP opens up the possibility of changing the approach so that the criterion for investing in AIF that invests in the crypto-assets is the same as the criterion for ICO participation.

5.9. The International element in ICO

An international element in ICO procedures is the fact that ICO is inseparably linked to the use of the Internet. The international element contributes to the success of the ICO procedure, as it enables investors in the Republic of Slovenia to easily access foreign ICOs and Slovenian issuers to easily access foreign investors. At the same time, the international element has a significant impact on the safety of the (Slovenian) investors.

Due to the existence of the international element in ICO procedures, there is a possibility that in legal disputes related to ICO procedures, different legislation may be applied. Regarding ICO procedures, we must, therefore, distinguish legislations governing:

the content of the obligations of the issuer,
the status - the legal form of the issuer,
the process of issuing tokens,
the functioning of the courts competent to resolve disputes.

In addition, if a dispute related to the ICO procedure is a consumer dispute, the regulations of the consumer's country of residence can also be applied.

Regardless of the foregoing, according to ATVP it is not appropriate to impose a legislation to be applied in the ICO procedure or regarding issues related to ICO procedure, except the provisions governing the token issuance procedure. A similar approach is already contained in ZNVP-1, which provides that the issuer can determine a legislation that will govern an obligation that is incorporated in a security. However, book-entry securities issued in the Republic of Slovenia must be issued in the manner prescribed by ZNVP-1.

5.10. Other relevant questions

Based on the received responses and the analysis of the wider environment in which token issuers operate, ATVP has identified some additional open issues arising from the legislation that is beyond its competence. Nevertheless, ATVP considers that it is necessary to address or at least point out some of the possible problems that issuers might encounter.

In addition to an obvious obstacle preventing tokens from being treated as securities, imposed by the Obligation Code requirement regarding the form, ATVP has identified some open issues also in the area of the consumer law, the issue of choice of law (Private International Law and Procedure Act), issues of commercial law and bankruptcy legislation, etc.
The laws, whose individual provisions, according to ATVP, should be addressed during the discussion of the future ICO regulation,[9] could be listed indicatively, as follows:

[9] Among the considered areas ATVP did not include the contents that are already being considered before other competent authorities and which have already been identified as problematic or not adapted to the ICO area, i.e. the area of taxes, banking legislation (payments) and money laundering and terrorist financing.

- **Consumer Protection Act** (Official Gazette of RS, No. 98/04 – official consolidated text,114/06 – Euro Adoption Act (ZUE), 126/07, 86/09, 78/11, 38/14, 19/15, 55/17 – ZKolT and 31/18):
    - the question of »digital content« as a form of goods; a clear position regarding the tokens and (non) application of the provisions Consumer Protection Act (ZVPot) on the sale of goods;
    - the question of the investor in tokens as a consumer when purchasing with cryptocurrency is concerned (which is not a means of payment), which represents, in principle, an exchange contract and not a sales contract; consequently it concerns the question of the application of the whole consumer legislation, as well as the safeguards Rome I and Brussels I Regulations, which restrict the right of the choice of law or forum in consumer contracts;
- **Private International Law and Procedure Act** (Official Gazette of RS No. 56/99 in 45/08 – ZArbit) and the related Rome I and Brussels I Regulations:
    - the question whether a token is a security and in accordance with the Obligation Code a unilateral legal transaction; in the latter case, Private International Law and Procedure Act (ZMZPP) provides that the law of the issuer's Member State applies, without the possibility of the choice of law.
    - For the majority of legal relationships, the Rome I Regulation will be used instead of ZMZPP, where the law of a Member State applies to "liabilities arising from bills of exchange, checks and promissory notes and from other transferable securities, insofar as the liabilities arising from such other transferable securities are based on their transferable nature".
    - From the question of whether the token holder is a consumer, as defined in Rome I and Brussels I[10] Regulations, it depends whether provisions that restrict the right of choice of law or the competent court will apply (Article 6 Rome I and Article 17 Brussels I)

- **Companies Act** (Official Gazette of RS, No. 65/09 – official consolidated text, 33/11, 91/11, 32/12, 57/12, 44/13 – decis. US, 82/13, 55/15 and 15/17)
    - The provision regarding shares that must be issued in book-entry form (Article 182, Companies Act, ZGD-1);

- **Financial Operations, Insolvency Proceedings and Compulsory Winding-up Act** (Official Gazette of RS, No. 13/14 – official consolidated text, 10/15 – popr., 27/16, 31/16 – decis. US, 38/16 – decis. US and 63/16 – ZD-C)
    - the question of Smart Contracts and the ban on the performance of acts that would lead to the unequal treatment of creditors who are in an equal position towards the company (Article 34 ZFPPIP) - or Smart Contracts on the basis of which a certain part of the issuer's assets are transferred to the holders of tokens, and the suspension of such transfers is allowed in the event of a possible initiation of the insolvency proceedings against the issuer.

- **Claim Enforcement** and **Security Act** (Official Gazette of RS, No. 3/07 – official consolidated text, 93/07, 37/08 – ZST-1, 45/08 – ZArbit, 28/09, 51/10, 26/11, 17/13 – decis. US, 45/14 – decis. US, 53/14, 58/14 – decis. US, 54/15, 76/15 – decis. US and 11/18)
    - Is it possible to enforce court decisions relating to a change in Blockchain records, given that the essential feature of the blockchain is

[10] A contract concluded by a physical person for a purpose which cannot be regarded as a business or professional activity of that person.

exchangeability, i.e. the absence of the possibility that the third party can arbitrarily (without knowing the private key of the holder)
change the blockchain records?

The above are merely some of the areas that ATVP finds relevant for discussion, and there are undoubtedly additional areas of legislative regulation where new technology will collide with certain obstacles and ambiguities.

6. CONCLUSION

According to the ATVP, on the basis of the analysis of public opinion, market conditions and procedures before the European authorities, the current legislation does not allow ICO to be classified within the relevant legal framework.

This situation does not allow for proper legal safety - either for investors or for issuers of tokens.

ATVP considers that even when the principle of technological neutrality is taken into account, it can be concluded that here we have a phenomenon and instruments that are so different from the existing financial instruments on the market and pose so many new challenges and issues that a *sui generis* regulation would be much more suitable for these instruments, individually - comparable and in accordance with the same principles that are applied in the field of financial instruments. Accordingly, ATVP considers that there is no reason to make difference between investment and utility tokens since in principle they pursue the same economic purpose.

The variety of new challenges and open issues arising from the use of new ways of financing with tokens requires a comprehensive approach by the legislator to fully regulate token operations, also outside the strict framework of the financial legislation.

According to ATVP, this is distinctively a cross-border phenomenon; therefore the adoption of local legislation, applicable only in the domestic market, would not provide adequate security for the participants and would not adequately regulate the situation. ATVP considers that only the regulation that would introduce a European passport, according to the already established example of other areas of financial legislation, would be appropriate.

ATVP will represent the positions and starting points presented in this Document primarily before the European authorities, and in case of possible legislative regulation of this area, also in the Republic of Slovenia.