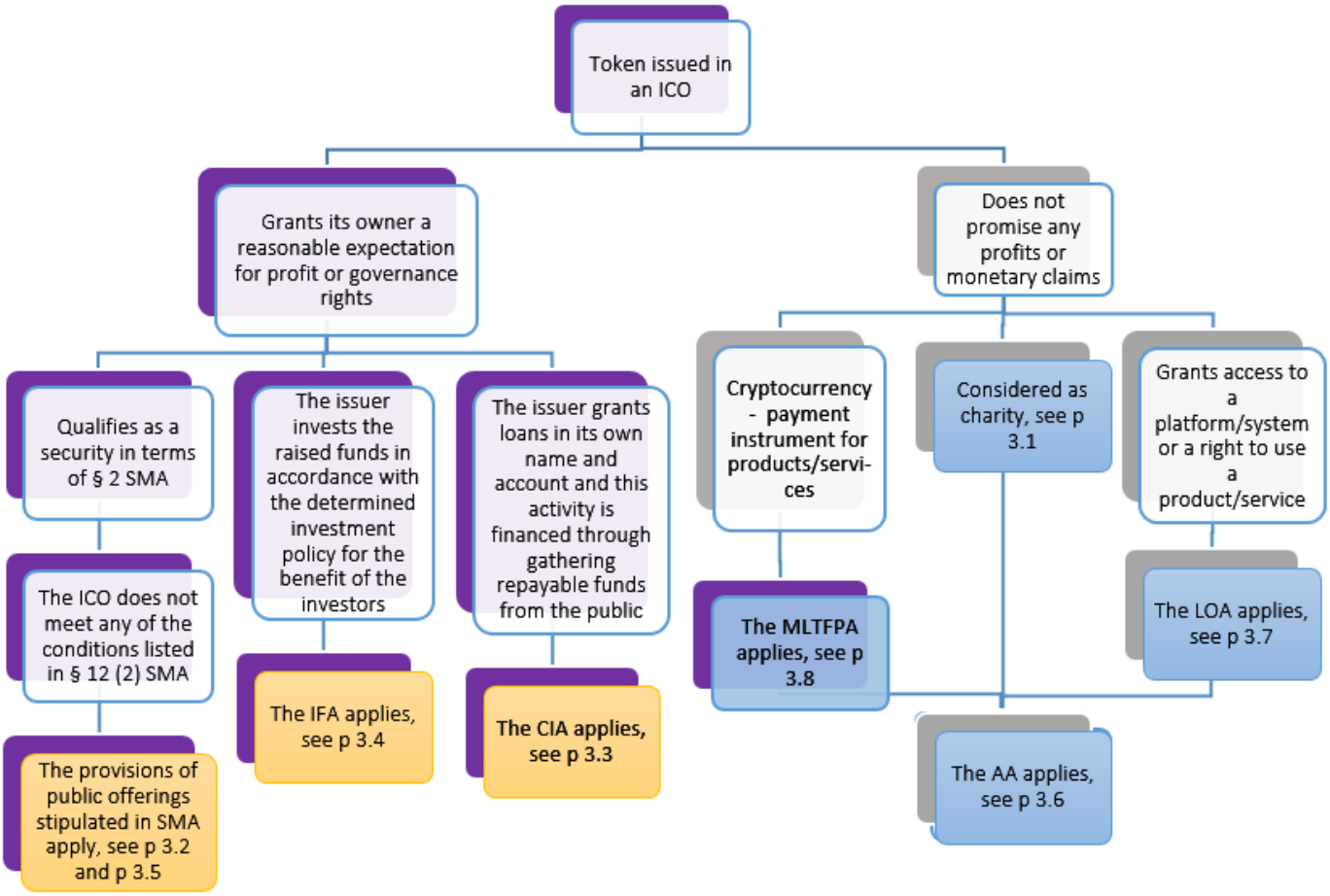
Information for entities engaging with virtual currencies and ICOs



EN: ICO raames pakutavad *token*'id ja neile kohalduvad regulatsioonid

1. I am mining cryptocurrency. Which regulations apply to this activity?

Mining cryptocurrency as a field of activity does not fall under the supervision of the Estonian Financial Supervision Authority (EFSA). However, we suggest to pay attention to taxation aspects. We refer to the publication of the Estonian Tax and Customs Board on taxation of income received in cryptocurrency, which can be accessed here. If you have any questions, please contact the Estonian Tax and Customs Board directly.

2. I would like to provide a virtual currency exchange service or a wallet service. Which authorisations I have to apply for?

Buying and selling virtual currencies could be subject to money laundering prevention regulations. Therefore, attention should be paid to § 70 (1) 4) and 5) and § 71 of the Money Laundering and Terrorist Financing Prevention Act (MLTFPA), which stipulates that in order to offer the service of exchanging virtual currency into fiat currency and the service of a virtual currency wallet, an appropriate authorisation must be granted from the Financial Intelligence Unit.

The application for authorisation can be submitted in the Register of Economic Activities accessible through the portal www.eesti.ee or the Tax and Customs Board page at https://mtr.mkm.ee. The state fee payable for the authorisation is 345 euros. Pursuant to § 71 of the MLTFPA, the Financial Intelligence Unit reviews the authorisation application no later than within 30 working days following the date of submission of the application. Prior to the grant of the authorisation, no services shall be offered. Pursuant to the MLTFPA, the obligation to hold an authorisation does not apply to the following: a person who holds an authorisation of the EFSA; a person who is obliged to apply for an authorisation from the EFSA pursuant to some other law; a person who has an authorisation of a financial supervision authority of a country of the European Economic Area that allows operating through a branch in Estonia or cross-border and the EFSA has been notified of such activity; or a person who offers the services referred to in § 70 (1) of the MLTFPA.

3. I would like to organise a (public) offering of tokens (ICO). Which regulations apply to this activity?

The first step is to analyse the rights granted by the tokens to identify whether they are securities or not as provided in § 2 of the Securities Market Act. Depending on the result of the analysis, the offering of tokens shall be either registered with the EFSA or not.
Tokens are classified as securities, if, for example, they (being proprietary right, obligation or contract) can be transferred on the basis of an at least unilateral expression of will or if they provide voting or decision making rights in the issuer or give the investor a certain return expectation regarding their investment (e.g. a right to a part of the issuer’s profit, regular cash flows, or any other promise about future profit), regardless of whether the funds raised are repayable by maturity date or no maturity date exists (e.g. a perpetual bond).

3.1 Donation

A fundraising for the development of a business project shall be considered as a donation only under the condition that it does not lead to (i) a participation in the issuer or (ii) any obligation to repay the funds, interest, dividend, or any other repayment, or cash flow. In addition, no right of use of a service or product shall arise in connection with the donation.

The describing documents of raising donations must prominently highlight that it is a donation and the donors are acting in good faith and knowingly waive their contribution. To learn more about the taxation of donations, please visit the website of the Estonian Tax and Customs Board.

3.2 The Securities Market Act (SMA) and the obligation to prepare a prospectus

Provided that tokens offered within an ICO qualify as securities, the provisions of the SMA regulating offerings of securities and the provision of investing services apply. It is important to assess whether it is a public offer of securities in terms of § 12 (2) of the SMA. An offer of securities is not deemed to be public when:

- an offer of securities is addressed solely to qualified investors, or

- an offer of securities is addressed to fewer than 150 persons per Contracting State, other than qualified investors, or
- an offer of securities is addressed to investors who acquire securities for a total consideration of at least 100,000 euros per investor, for each separate offer, or
- an offer of securities is with the nominal value or book value of at least 100,000 euros per security, or
- an offer of securities is with a total consideration of less than 2,500,000 euros per all the Contracting States in total calculated in a one-year period of the offer of the securities.

If none of the above conditions exist, the offer is deemed to be a public offer, in which case a prospectus for the offer must be prepared and registered with the EFSA.

Pursuant to § 17 (4) and (4 superscript 1) of the SMA, in the case of an offer with a total consideration of less than 5,000,000 euros, the prospectus shall be prepared in accordance with the Prospectus Regulation No. 809/2004/EC of the European Union (Prospectus Regulation) or a regulation established by the minister responsible for the area. In the case of public offers with a total consideration of over 5,000,000 euros, the prospectus must be prepared in accordance with the abovementioned Prospectus Regulation.

All listing prospectuses must be prepared in accordance with the Prospectus Regulation. The level of detail of the prospectus depends on the qualification of the securities to be offered. The Prospectus Regulation stipulates somewhat different requirements, for example, for public offers of securities and bonds. Estonian law does not currently provide for exceptions (or other special provisions regulating ICOs) from the existing securities regulation.

However, the Prospectus Regulation grants some exceptions for start-up companies when preparing a prospectus. Such are companies that have existed for less than three years. The adaptions to the minimum information given are specified in Article 23 of the Prospectus Regulation. More detailed descriptions can be found in the document ‘ESMA Update of the CESR recommendations. The consistent implementation of Commission Regulation (EC) No 809/2004 implementing the Prospectus Directive’ (20 March 2013) and ‘ESMA Q&A Prospectuses’ (October 2017).

A decision concerning the registration of a prospectus from an issuer that does not have any securities admitted to trading on a regulated market or who has not previously offered securities to the public shall be made no later than within 20 working days from the submission of the prospectus that is compliant with the legislation. The total length of proceedings of a prospectus registration depends on various factors. In practice, the procedure can take around 3?6 months, depending on the initial quality of the prospectus, the need to amend it, and how fast the necessary amendments are made.
Please see also section 4.

3.3 Credit Institutions Act (CIA)

A company that offers tokens may also be subject to the CIA and the requirement to have a credit institution authorisation pursuant to the Act. This applies if the company is constantly granting loans in its own name and account and if the financing of this activity is gained from ICOs by raising repayable funds from the public. Such an activity may qualify as that of a credit institution or a bank, for which authorisation must be applied for at the EFSA. The EFSA has previously published in their memorandum ‘The Field of Activity of Credit Institutions’ that, under certain conditions, raising repayable funds from the public could be qualified as an offering of securities.

3.4 Investment Funds Act (IFA)

Depending on the specific structure and objective of an ICO, the IFA may be applicable – for example if investors' capital is raised in an ICO with the aim of further investing it in accordance with the determined investing policy for the benefit of the investors and in common interests. Pursuant to § 2 (3) of the IFA, this fund must have a fund manager. In particular, § 3 (1) of the IFA specifies that a fund manager is a company whose main and permanent activity is management of one or several funds. A management company can manage a fund or several funds founded or established in accordance with the IFA, including a fund founded or established under the law of a foreign state.

Pursuant to § 3 (2) of the IFA, a person is required to apply for an authorisation to act as a fund manager or register its activity at the EFSA in accordance with the provisions of Part 5 of the IFA. This is required regardless of the platform used to raise the funds. The IFA specifies various types of fund managers and distinctions depending on whether the units of the investment fund are offered publicly or not.

A useful material for qualifying an investment fund is the ESMA guideline 'Guidance on the implementation and interpretation of the directive on alternative investment fund managers'.

3.5 Securities Register Maintenance Act (SRMA)

Pursuant to § 2 (1) of the SRMA, the following securities have to be entered in the register:

- debt obligations issued by a legal person in private law registered in Estonia, the public offer prospectus of which shall be registered with the EFSA pursuant to the Securities Market Act;
- the units and shares of investment funds registered in Estonia, which are admitted for trading on a regulated securities market or in a multilateral trading facility;
- subscription rights for shares and for securities subject to entry in the register, which are publicly issued or publicly offered.

3.6 Advertising Act (AA)

When advertising an ICO, it is important to carefully consider the use of terms in the advertisement and the general requirements for advertising stipulated in the Chapter 2 of the AA. The advertising must provide a clear and true presentation of the product or service to the persons targeted. In particular, advertising must not be misleading concerning the characteristics of the offered product or service. For example, advertising something as an investment service could be unlawful without the required authorisation (as stated in the provisions § 3 (4) 11) and 16); § 4 (1) and § 29 (1) and (3) of the AA). A utility token must not be advertised as an investment or an investment object.

3.7 Law of Obligations Act (LOA)

An ICO where the tokens offered grant their purchasers access to a product or service is in essence a prepayment for a product or service. Consequently - taking into account that the contracts entered into within an ICO use means of communication (a computer network) - such ICOs are subject to the provisions of the LOA regarding the distance contracts entered into through means of communication and computer network.

Pursuant to § 54 and § 62 superscript 1 (2) and 62 superscript 2 (1) of the LOA, the person organising an ICO must inform the investors of the main characteristics of the object of the contract,

the total price of the object of the contract, including the taxes, the duration of the contract or conditions for terminating the contract and other rights and obligations arising from the contract and its technical stages. This information must be emphasized and stated clearly. In case of a withdrawal of the contract, § 56 superscript 1 (1) of the LOA obliges the token issuer to return the consumer (investor) everything received based on the contract.

3.8 Money Laundering and Terrorist Financing Prevention Act (MLTFPA)

In case the tokens are intended to be exclusively used as a means of payment for acquiring goods or services or as a means of money or value transfer, they shall be considered as payment tokens. Such tokens do not give rise to any claims on their issuer. The definition of payment tokens corresponds to that of a virtual currency in the provision § 3 point 9 of the MLTFPA, being a value represented in the digital form, which is digitally transferable, preservable or tradable and which natural persons or legal persons accept as a payment instrument, but that is not the legal tender of any country or funds for the purposes of Article 4(25) of Directive (EU) 2015/2366 of the European Parliament and of the Council on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (OJ L 337, 23.12.2015, pp. 35–127) or a payment transaction for the purposes of points (k) and (l) of Article 3 of the same Directive.

The issuers of payment tokens, where the payments are accepted also in fiat money, should follow the at least the due diligence measures provided in the MLTFPA.

4. I am trading/investing tokens. Do I need an authorisation for these activities?

An activity licence of an investment firm is necessary when the tokens qualify as securities and the firm offers one or more of the following services as a permanent activity:

- reception and transmission of orders related to tokens;
- execution of orders related to tokens on behalf of or for the account of the client;
- dealing in tokens on their own account;
- management of a securities portfolio (consisting of tokens);
- provision of investment advice regarding tokens;
- guarantee of token or guarantee of the offer, issue, or sale of tokens;
- organising an offer or issue of tokens (organising ICOs);
- operation of a multilateral trading facility which brings together the non-simultaneous or simultaneous interests of different people for the acquisition and transfer of securities under non-discretionary conditions, which result in a contract;
- operation of an organised trading facility.

There is no obligation for an investment firm licence provided that the circumstances listed in § 47 of the SMA exist.

Operation of a multilateral trading facility or an organised trading facility should not be understood as a mere displaying of interests of acquisition and transfer of tokens where the relevant website does not allow making such transactions. However, if the person displaying the transactions is the other party to the transaction, § 42 (1) 3) of the SMA applies, i.e. this qualifies as trading tokens on a person’s own account.

It is also important to note that in addition to a relevant licence, such firms must also comply with the

provisions stipulated in Part 3 of the SMA.

5. I am planning an ICO and would like to contact the EFSA regarding this. Which preliminary information I should provide and what do I have to take into account in my analysis?

In order to receive a feedback or discuss a specific ICO and the laws applicable to it, it is important to have analysed and provide the EFSA beforehand at least the following:

1. Name of the project for which funds are to be raised;
2. Name and contact details of the project company/ICO organiser;
3. Timeline of the project: timeline of fundraising, project implementation milestones;
4. Description of the developed/offered product/service (main characteristics);
5. Which investors does the ICO target?
6. Will there be any restrictions for the investors?
7. Which technological solutions will be used in the project/ICO?
8. In which (virtual) currency and how is it possible to invest into the project?
9. What is the volume of the ICO?
10. How and where will the funds be allocated?
11. Will a new token be created within the ICO? How?
12. When and how is the token transferred to the investor?
13. What are the characteristics and functions of the token?
14. What rights does the token grant to the investor?
15. How will compliance with the provisions of the MLTFPA be ensured in terms of the ICO?
16. How and where is it possible to sell or buy the token later?
17. Can the token be used to buy products/services or to make payments to third persons?
18. Does the token issuer plan to repurchase the tokens?

6. What are the consequences of non-compliance with the law?

If the abovementioned legal framework is not pursued or if false information is presented during an ICO, it may be classified as fraud. In particular, investment fraud in terms of § 211 of the Penal Code (PC) or as conducting an economic activity without a relevant licence as stated in § 372 of the PC. In addition, several financial sector misdemeanours may apply.

7. Recommendation

As there are numerous circumstances related to the organisation of an ICO that must be taken into consideration, we recommend engaging with a relevant legal expert.

8. Disclaimers

Please note that the abovementioned instruments are still evolving and their legal framework and interpretation practices (including the respective legal framework on the EU level) may change. Therefore the EFSA reserves itself the right to alter or amend the current interpretation.

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