

Latham & Watkins [Capital Markets](#) and [Financial Regulatory](#)
Practices and [FinTech](#) Industry Group

February 27, 2018 | Number 2282

BaFin Publishes Statement on ICO and Token Regulation

BaFin, the German Federal Financial Services Supervisory Authority, joins global regulators in releasing guidance for German ICO issuers and advisors.

The growing number and commercial significance of cryptographic token offerings (so-called Initial Coin Offerings, or ICOs) has lead financial supervisory authorities across numerous jurisdictions to release statements regarding the regulation of ICOs and tokens. For example, the Securities Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) in the United States, the Autorité des Marchés Financiers (AMF) in France, the Authority for the Financial Markets (AFM) in the Netherlands, and the Financial Market Supervisory Authority (FINMA) in Switzerland have all released statements in the last six months. The German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, or BaFin) had so far only issued a general consumer warning regarding ICOs. However, amid increasing inquiries relating to ICOs and cryptocurrencies, BaFin recently published a statement on the regulatory treatment of ICOs as a matter of securities law compliance.

This *Client Alert* summarizes the key points in the BaFin statement.

General rules apply to ICOs

BaFin stresses that tokens are subject to the general financial regulatory rules if the tokens qualify as a regulated financial instrument, *i.e.*, there is no regulatory regime specific to ICOs. This is in line with the position of other regulators, such as those in the United Kingdom, Switzerland, Hong Kong, and Singapore. Along the same lines, in the United States, the SEC Chairman has issued a stark warning to ICO market participants and gatekeepers that ICO issuers must comply with the US securities laws if they are offering tokens to US investors that qualify as “investments”. In contrast, jurisdictions like Gibraltar and Belarus have announced specific regulatory regimes tailored to ICOs that are designed to attract ICO issuers. Yet other jurisdictions are taking a more restrictive approach. For example, China and South Korea have banned ICO issuances entirely.

Applicable regulatory requirements in Germany

According to BaFin’s statement, under German financial regulatory law tokens may in particular constitute any of the following:

- Securities
- Asset investments
- Units in investment funds
- Underlyings of derivatives contracts
- Units of account

Depending on the classification as one of the aforementioned instruments, the offering and trading of cryptographic tokens, including cryptographic currencies, as well as other services relating to such tokens, are potentially subject to the following rules:

- **Prospectus requirements** for token issuances under the:
 - Securities Prospectus Act (*Wertpapierprospektgesetz*, or WpPG) if the tokens qualify as securities
 - Assets Investment Act (*Vermögensanlagegesetz*, or VermAnlG) if the tokens qualify as asset investments
 - Capital Investment Code (*Kapitalanlagegesetzbuch*, or KAGB) if the tokens qualify as units in investment funds (further filing and approval requirements apply)

- **Licensing requirements** under the:
 - Banking Act (*Gesetz über das Kreditwesen*, or KWG) for conducting banking business and providing financial services (including, *inter alia*, marketing and trading activities)
 - Payment Services Supervisory Act (*Zahlungsdienstenaufsichtsgesetz*, or ZAG) for providing payment services or issuing electronic money
 - Capital Investment Code (KAGB) for the investment fund manager if the tokens qualify as units in investment funds

- **Trading regulations** under the:
 - Securities Trading Act (*Wertpapierhandelsgesetz*, or WpHG)
 - European regulations with direct effect in the context of the MiFID II regime, such as the Market Abuse Regulation (MAR) and the Markets in Financial Instruments Regulation (MiFIR)

Qualification of tokens as securities

BaFin clarifies that cryptographic tokens may qualify as securities, noting that the immaterial nature of cryptographic tokens does not preclude tokens from being securities. The clarification relates to an ongoing debate on whether or not under German law the concept of a “transferable security negotiable on capital or financial markets” necessarily presupposes that rights are either represented by a physical instrument or, if represented in other ways (such as a registry entry), such representations need to be declared as equivalent to securities on a statutory basis. BaFin takes the view that it suffices if the holder of the token can be documented in a blockchain, and that representation by a physical instrument is not necessary. With regard to the requirement that securities be “negotiable on capital or financial markets,” BaFin stated that cryptocurrency exchanges will, in principle, be considered such capital or financial markets.

In summary, according to BaFin, tokens may qualify as securities if:

- They can be transferred, and are negotiable on financial or capital markets.
- They represent membership rights or claims (or any comparable rights).
- They are not payment instruments (pursuant to Art. 4 (1) No. 44 MiFID II).
- The holder can be documented in a blockchain or distributed ledger (or similar) technology (no representation by a physical instrument required).

A classification as a security would, in particular, subject tokens to the prospectus requirements of the WpPG, as well as the securities trading regulations pursuant to the MiFID II regime (including MiFIR and MAR), and the WpHG.

Qualification of non-security tokens as other types of financial instruments

BaFin notes that tokens which do not qualify as securities may qualify as other types of financial instruments, highlighting the following instrument types as potentially relevant in the context of ICOs:

- **Asset Investments.** Tokens may constitute asset investments pursuant to the VermAnlG. Asset investments cover a broad range of investment products, such as units that grant a participation in the result of a company (*Unternehmensbeteiligung*), profit-participating loans (*partiarisches Darlehen*), subordinated loans (*Nachrangdarlehen*), participation rights (*Genussrecht*), or other investment products that provide for a cash compensation in exchange for making money available on a temporary basis (*sonstige Anlage*). Similar to securities, asset investments are subject to certain prospectus requirements and to the securities trading regulations.
- **Units in investment funds.** If the tokens are considered to be units in investment funds within the meaning of the KAGB and Annex I Part C (3) MiFID II, the token issuance is subject to prospectus requirements and the fund manager to licensing requirements under the KAGB. An investment fund as defined in Section 1 (1) KAGB is a “collective investment undertaking that is not a business operating outside the financial sector collecting capital from at least two investors with a view to investing such capital in accordance with a specified investment strategy for the benefit of the investors.”
- **Underlying assets of derivatives contracts.** According to BaFin, tokens can be an underlying asset for derivatives. Depending on the nature of the derivatives contract, prospectus, licensing, and secondary market rules would apply.

However, BaFin does not provide any details on the characteristics that would lead to a token falling within the definition of such other types of financial instruments. BaFin rather stresses that it will always assess cryptographic tokens on a case-by-case basis, taking into account the individual facts and circumstances. Therefore, uncertainties remain, particularly relating to the precise requirements for asset investments in the form of “participation rights” and “other investment products.”

Licensing requirements pursuant to the German Banking Act

BaFin further notes that services provided in relation to tokens which qualify as securities or other types of financial instruments may trigger a license requirement under the German Banking Act (KWG) for the conduct of banking business activities or provision of financial services. Such licensing requirements may in particular apply to service providers involved in marketing and processing the ICO or operation of secondary market trading facilities.

In this context, BaFin further highlights the broad scope of financial instruments for purposes of the German Banking Act (KWG), which, beyond the financial instruments already mentioned, also includes “units of account” (*Rechnungseinheiten*). As BaFin explicitly noted in prior statements, cryptocurrencies may constitute such units of account. This is particularly relevant for so-called utility tokens, which often qualify only as units of account, but not as any other type of financial instrument. For such tokens, secondary market trading activities may require a license under the German Banking Act (KWG); on the other hand, however, the trading regulations of the German Securities Trading Act (WpHG) do not apply.

Licensing requirements under the Payment Services Supervision Act

Additionally, BaFin stresses that third parties involved in transferring fiat currency between parties on cryptocurrency exchanges may be subject to the licensing requirements of the German Payment Services

Supervisory Act (ZAG). It should be noted in this context that BaFin applies a wide interpretation of what types of activities constitute payment services.

In line with BaFin's supervisory practice so far, the BaFin statement makes clear that ICOs are generally feasible in Germany provided that they comply with existing regulatory requirements. However, uncertainties remain regarding the exact classification of a given token design as a specific financial instrument. Therefore, careful structuring of the ICO is imperative to avoid undesired regulatory implications.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Marcus C. Funke

marcus.funke@lw.com
+49.69.6062.6415
Frankfurt

Axel Schiemann

axel.schiemann@lw.com
+49.69.6062.6509
Frankfurt

Markus E. Krüger

Markus.krueger@lw.com
+49.69.6062.6641
Frankfurt

Frank Bierwirth

frank.bierwirth@lw.com
+49.69.6062.6547
Frankfurt

Wenchi Hu

wenchi.hu@lw.com
+1.212.906.1655
New York

Stuart Davis

stuart.davis@lw.com
+44.20.7710.1821
London

Stephen P. Wink

stephen.wink@lw.com
+1.212.906.1229
New York

Max von Cube

max.voncube@lw.com
+49.69.6062.6646
Frankfurt

You Might Also Be Interested In

[Initial Coin Offerings — An Unregulated Market?](#)

[Europe as a Hub for Initial Coin Offerings?](#)

[ESMA Highlights EU Regulatory Rules Applicable to ICOs](#)

[Coining it in: ICOs as the New Fundraising Paradigm?](#)

[CFTC Proposes Interpretation of “Actual Delivery” for Virtual Currencies](#)

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the lawyer with whom you normally consult. The invitation to contact is not a solicitation for legal work under the laws of any jurisdiction in which Latham lawyers are not authorized to practice. A complete list of Latham's *Client Alerts* can be found at www.lw.com. If you wish to update your contact details or customize the information you receive from Latham & Watkins, visit <https://www.sites.lwcommunicate.com/5/178/forms-english/subscribe.asp> to subscribe to the firm's global client mailings program.