

[Securities Regulation Daily Wrap Up, TOP STORY—SEC imposes first penalties for non-fraud unregistered ICOs; offers compliance path for other ICOs, \(Nov. 16, 2018\)](#)

Securities Regulation Daily Wrap Up

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In the SEC's first civil penalties against issuers of unregistered initial coin offerings (ICOs) where no fraud was involved, two ICO issuers agreed to pay \$250,000 each and to return funds to harmed investors, register the tokens as securities, and file periodic reports with the Commission. SEC staff stressed the need for ICOs to comply with the federal securities laws and said the settlement provides a model for other ICO issuers to gain compliance (*In the Matter of Paragon Coin, Inc.*, [Release No. 33-10574](#) and *In the Matter of CarrierEQ Inc. d/b/a Airfox*, [Release No. 33-10575](#), November 16, 2018).

"We have made it clear that companies that issue securities through ICOs are required to comply with existing statutes and rules governing the registration of securities," [said](#) Stephanie Avakian, Co-Director of the SEC's Enforcement Division. "These cases tell those who are considering taking similar actions that we continue to be on the lookout for violations of the federal securities laws with respect to digital assets."

No fraud, just failure to register. In 2017, CarrierEQ Inc. (Airfox) and Paragon Coin Inc. conducted ICOs without filing registration statements. Airfox raised about \$15 million to finance a token-denominated "ecosystem" involving a mobile application that would allow users in emerging markets to earn tokens by interacting with advertisements. Paragon raised about \$12 million in a plan to use blockchain technology in the cannabis industry and work toward legalization of cannabis. The SEC found that the tokens were securities under a *Howey* analysis and that neither qualified for an exemption from registration.

In consenting to the \$250,000 penalties, token registration, and other undertakings, the issuers did not admit or deny the findings.

Joint statement. The Division of Corporation Finance, Division of Investment Management, and Division of Trading and Markets issued a [joint statement](#) providing their views on:

1. initial offers and sales of digital asset securities (including those issued in ICOs);
2. investment vehicles investing in digital asset securities and those who advise others about investing in these securities; and
3. secondary market trading of digital asset securities.

Staff recommended that those employing new technologies consult legal counsel about the application of the federal securities laws and contact SEC staff for assistance as necessary.

Other warnings on need to register ICOs. The SEC has provided several cautions to ICO issuers about the need to register their offerings if the tokens are securities. In July 2017, the SEC issued the [DAO Report of Investigation](#) finding that the sale of tokens for The DAO, a digital autonomous organization, may have violated federal securities laws. The SEC did not pursue an enforcement action at that time.

Next, in December 2017, the SEC brought its first non-fraud ICO registration case. Although [Munchee Inc.](#) had conducted its own *Howey* analysis and decided that its tokens did not require registration, the SEC found that in fact the tokens were investment contracts sold in violation of the registration provisions in Sections 5(a) and 5(c) of the Securities Act. The SEC did not impose a penalty because the company promptly halted the ICO and returned the proceeds before issuing any tokens and cooperated in the SEC's investigation.

Path to compliance for other ICO issuers. According to the Divisions' statement, the settlements show that there is a path to compliance with the federal securities laws going forward—even where issuers have already conducted an illegal unregistered offering of digital asset securities.

Steven Peikin, co-director of the SEC's Enforcement Division, agreed. "By providing investors who purchased securities in these ICOs with the opportunity to be reimbursed and having the issuers register their tokens with the SEC, these orders provide a model for companies that have issued tokens in ICOs and seek to comply with the federal securities laws," he said.

William Hinman, director of the Division of Corporation Finance, recently [said](#) that the Division expects to release plain-English guidance on digital assets by early 2019.

The releases are Nos. [33-10574](#) (Paragon) and [33-10575](#) (Airfox).

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