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SEC Issues Investigative Report – Concludes DAO Tokens are a Security

On July 25, 2017, the SEC issued a press release <https://www.sec.gov/news/press-release/2017-131> announcing the conclusion of an investigative report into whether offerings of digital assets by “virtual” organizations are securities and therefore subject to the federal securities laws. In its investigative report <https://www.sec.gov/litigation/investreport/34-81207.pdf> the SEC concluded that “Initial Coin Offerings”, “Token Sales” and similar offerings using distributed ledger or block chain technology are securities and are subject to regulation as such.

The incidence of such Initial Coin Offerings using block chain and similar technology have been increasing over the past few years and, as a result, the SEC felt that it was appropriate to investigate whether the “coins” or “tokens” offered constitute securities, thus making such offerings subject to federal securities laws. In its report, the SEC concluded that indeed such coins or tokens were securities because they met the basic test for what constitutes a security under the federal securities laws. This test, which was first set forth SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946), states that the “touchstone” of what constitutes a security or investment contract “is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.”

In the report the SEC analyzed the offering conducted by DAO, a virtual organization and Slock.it UG, a German corporation. The SEC determined that in light of the facts and circumstances, it would not recommend enforcement action against either DAO or Slock.it but urged market participants to use the report as guidance for future offerings of virtual coins or tokens which may be classified as securities. The SEC reminded market participants that any offering of securities in the United States must either be registered with the SEC or be subject to an exemption from such registration.

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