



Is Cryptocurrency a Security?

Globally, as at November 7, 2020, there were over 6,700 types of cryptocurrencies including, Bitcoin, the most popular digital currency, which currently trades at USD\$15,014.90. This amounts to approximately TTD\$101,964.75. At the beginning of the fourth quarter of 2020, cryptocurrencies recorded a cumulative market capitalisation of USD\$237.1 billion. Despite this, there are many concerns regarding the use of cryptocurrency including the substantial fluctuation in the market price, the regulatory and legal oversight, and of course, the looming question regarding whether it is a security.

In previous articles, the Trinidad and Tobago Securities and Exchange Commission (“TTSEC”) discussed the importance of Financial Technology (Fintech) and the potential for Fintech products and services in the securities market. The TTSEC also discussed the topic of securities and its characteristics. This week’s article will discuss the topic of cryptocurrencies and whether it can be considered securities.



What is a cryptocurrency?

Cryptocurrencies are digital financial assets which can be crypto-mined¹ or purchased through an online exchange or via Initial Coin Offerings (ICOs)². These digital currencies use cryptographic³ technology to provide a secure electronic transaction. This is achieved by using a decentralised system of blockchain encryption technology⁴ to control the amount of currency issued and to record ownership and payments. It must be noted, that cryptocurrency is digital and not

considered to be legal tender such as coins or notes, as it does not have all the attributes of real currency. Furthermore, cryptocurrencies must be stored on a digital wallet and cannot be physically withdrawn to be used as a form of payment for the exchange of an item or service. However, transfers through digital wallets can be done for payments and receipts.

¹ “cryptomining uses the processing power of computers to solve complex mathematical problems and verify cybercurrency transactions, and the miners are then rewarded with a small amount of cybercurrency.”

² An initial coin offering (ICO) is the cryptocurrency industry’s equivalent to an initial public offering (IPO). A company looking to raise money to create a new coin, app, or service launches an ICO as a way to raise funds.

³ “Cryptography is a method of protecting information and communications through the use of codes, so that only those for whom the information is intended can read and process it.”

⁴ “Blockchain encryption prevents sensitive information from getting into the wrong hands, and being misused or forged”

Is Cryptocurrency a Security?

For many, the cryptocurrency market gives the impression of a lucrative security worthy of investment. An overabundance of advertisements is disseminated through popular social networking sites, highlighting the great returns from investing in these “crypto assets”; but are cryptocurrencies securities? Will you gain lucrative returns once you purchase it? The answer, depends on various factors. In the United States of America, the precedent lies in a particular Supreme Court case - SEC v. W.J. Howey Co., 328 U.S. 293 (1946)) or more popularly known as the “Howey Test”. This test is used globally to determine whether a product is a security.

The Howey test states that a financial instrument, such as a crypto asset, will be considered an “investment contract,” and therefore a “security,” where there is an investment:

1. Of money (which could include, for example, an investment of fiat currency or cryptocurrency).
2. In a common enterprise.
3. With an expectation of profit derived from the managerial or entrepreneurial efforts of others.

Overall if a person invests their money in a common enterprise and is led to expect profits solely from the efforts of others, this can be considered a security.

In June of 2019 the United States Securities and Exchange Commission’s (US SEC’s) chairman Jay Clayton further clarify that Bitcoin is not a security. Clayton stated that “Cryptocurrencies are replacements for sovereign currencies... [they] replace the yen, the dollar, the euro with Bitcoin. That type of currency is not a security.”

When considering what is a security, Initial Coin Offerings (ICOs) seem to fit the definition of a Security a bit clearer than Cryptocurrencies. According to International Organization of Securities Commissions (IOSCO), ICOs, “(also known as token sales or coin sales), typically involves the creation of digital tokens – using distributed ledger technology⁵ – and their sale to investors by auction or through subscription, in return for a crypto-currency”.

In August of 2020, the US SEC made a rather powerful move that may chart the path for cryptocurrencies to become a security in the future. The chairman stated that the US SEC is working with other financial regulators to determine who has regulatory jurisdiction over different crypto products. He went on to state that “If you’re talking about . . . the tokenisation of ETFs (exchange-traded fund) ... We should drive that, and we’re willing to drive that.”

Within our region, individual countries are making strides within the crypto market. The Jamaica Stock Exchange is currently working on the regulatory framework to facilitate crypto-asset trading and Barbados based company BITT, launched its payment system which utilises blockchain and distributed ledger technology.

⁵ “Distributed ledger technology (DLT) is a digital system for recording the transaction of assets in which the transactions and their details are recorded in multiple places at the same time.”

Are Cryptocurrencies recognise as a security in Trinidad and Tobago?

Similar to our regional and international counterparts, the TTSEC has undertaken a strategic approach to dealing with cryptocurrencies within our market. All Cryptocurrencies originating from Trinidad and Tobago will need to be reviewed on a case by case basis to determine if it is a security or otherwise. This will determine who the appropriate regulator should be. The TTSEC along with other financial regulators, are seeking to implement various regulatory tools such as Innovation Hubs and Regulatory Sandboxes to aid in the regulation of Fintech products and services. Fintech products such as Cryptocurrencies are continuously evolving and may be similar or different to popular Cryptocurrencies in the market. Therefore, the aforementioned regulatory tools will aid regulators in understanding the products and determining the regulatory requirements. To date, no cryptocurrencies have been registered with the TTSEC.

Should you invest in cryptocurrencies?

Most online exchanges for cryptocurrencies are unregulated. In an unregulated environment, there is significantly less investor protection than in traditional securities markets and considerably more opportunities for fraud and manipulation. As such, it's important to understand the risks before you invest. The following questions must be asked:

1. Is the initial coin offering registered with the TTSEC? As stated above there are no registered cryptocurrencies in Trinidad and Tobago.
2. Does the opportunity sound too good to be true, or are you pressured to act quickly?
3. If a blockchain is used, is the blockchain open and public?
4. Who is issuing, sponsoring and promoting or marketing the product?
5. What specific rights come with my investment?
6. Does the company have financial statements? If so, are they audited, and by whom?
7. Is there trading data? If so, is there some way to verify it?
8. If a digital wallet is involved, what happens if I lose the key? Will I still have access to my investment?

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