



**Philippine Association for
Digital Commerce and
Decentralized Industries
(PADCDI)**

**PADCDI Position Paper Re: Request for Comments on the SEC Proposed Rules on
Initial Coin Offering (ICO)
16 August 2018**

**SEC Initial Coin Offering (ICO) Rules a Step in Right Direction Towards a Digital
Asset and Cryptocurrency Era; PADCDI Asks SEC to Improve Ease of Doing Business
in the Philippines While Protecting Unsophisticated Investors**

Background

On 02 August 2018, the Markets and Securities Regulation Department of the Philippine Securities and Exchange Commission (SEC) released a document titled *Request for Comments on the Proposed Rules on Initial Coin Offering (ICO)* through the SEC website, containing the draft rules regulating the conduct of ICOs by startups and/or registered corporations organized in the Philippines, or ICOs that target Filipinos through online platforms. The document also provides for a window wherein individuals and organizations can submit their comments regarding the draft rules.

As an organization representing the interests of companies dealing with digital commerce - including cryptocurrencies and other forms of digital assets - the Philippine Association for Digital Commerce and Decentralized Industry (PADCDI) collected the feedback of its industry members from 03-13 August 2018.

This document serves as a summary of the various talking points that will be raised by PADCDI with the SEC, and as a reference for its industry and individual members to create their own comments to be submitted to the SEC.

Talking Points

PADCDI members interpret the SEC rules as defining all tokens as securities unless otherwise proven by the issuer

Based on the proposed rules, it appears that the SEC's default stand on ICOs is that these companies are issuers of securities, unless proven otherwise by the token issuer through the submission of a legal opinion proving the contrary. The general consensus is that the Commission's recognition of some tokens as securities is reasonable and may in fact open the door to greater acceptance of digital/crypto assets in mainstream trading venues.

However, some individuals have expressed concern about how the process of legal justification may hamper innovation and flexibility in the field by pinning down existing issuers to either a security or non-security model, and by forcing new startups to weather potential repeated legal challenges from the SEC.

PADCDI is willing to work with the Commission to fully qualify the behavior of security and non-security tokens (e.g. pure utility, reward, payment, points, redemption, etc.) based on the SRC, prevailing and future regulatory positions of the Bangko Sentral ng



Pilipinas, and future technological developments, as well as to assist the Commission in defining the treatment of operational token issuers. The artifact of this collaboration could be an assessment matrix that qualifies nature and behavior of a token in a way that discounts arbitrary classification of tokens as securities.

SEC's compliance requirements are fewer than the requirements required by PADCDI
The SEC's initial set of rules provide for significantly fewer documentary requirements compared to what is asked for by PADCDI. Notably absent from the proposed SEC rules is the requirement to submit the following documents:

- Data Privacy Policy;
- AMLA/Countering Terrorism Funding (CTF) Policy;
- Record Keeping Policy and samples of records;
- Compliance/Due Diligence assessment reports of all third party technical and liquidity partners engaged by the company (including copies of written agreements for high-risk third parties);
- Evidence of KYC logging capability, showing logs containing customer location/IP at time of transaction, funding provider and location, and the name and location of the payee involving customers and other people; and
- Certifications from Self-Regulatory Organizations (SROs), if any

PADCDI asks the Commission to assess whether the minimum standards set in the draft are sufficient in this new frontier of digital asset trading, and to consider the additional requirements enumerated above in its process of assessment and certification. Furthermore, if the Commission deems their requirements to be final, then these must be stated in the working document, with changes added only after public consultation. Reasonable changes accepted for implementation must be clearly indicated as being prospective and without any qualified retroactive effect.

Retroactive enforcement of the rules should be clear and grounded in reason, accounting for previous and current business models

While PADCDI sees that the rules are in itself reasonable, concerns have been raised regarding ICOs that have pivoted and/or changed its token model between the beginning of its operations up to when the rules take effect. Although the rules have stated that existing projects must submit "Operations Manual detailing the system architecture, documentations and the corresponding source codes and commands, including detailed flowcharts of the process" (Art. 2, Sec. 1, Item h.) it is unclear at the moment whether or not companies need to provide information only on how it is currently operating, or in the case of companies that have pivoted or changed business/token models at least once, what structures were implemented from the beginning of operations. This is important since the SEC itself has in the recent past provided legal rulings and guidance interpreting rules as having only prospective effect (See: SEC-OGC Opinion No. 08-22 dated 13 October 2008).

In this regard, PADCDI urges the Commission to provide a clearer guide for companies already in existence to conform to, whether or not they have changed business or



token models at least once over the course of its operations. The Commission should also clearly define the assessment process and standards that companies which are already in the process of, running, or have already completed their ICO, should be subjected to.

Enforcement of policies for all existing token holders will be difficult to conduct, thus targeted enforcement should be the focus of the Commission

ICOs have been taking place since 2014, when Vitalik Buterin first offered Ether in exchange for Bitcoin. Since then, thousands of tokens on various distributed ledgers have fallen into the possession of Filipinos, both inside and outside the Philippines. In the absence of a ruling clarifying the nature of digital assets such as crypto tokens, the SEC faces the challenge of identifying all projects that have, are, or will, in any method deemed by the Commission to be part of permitted targeted marketing methods, offer access to Filipinos and the Philippines in general.

PADCDI supports the Commission in its objective to protect ordinary individuals from predatory companies seeking to exploit the uptrend in digital asset tokenization, but urges the Commission to adopt a stance focused on targeted enforcement of its policies rather than blanket pronouncements on the nature of ICOs and all tokens. Also, such targeted enforcement of its policies shall be made clearly limited only to tokens deemed to be a “security” after the SEC’s rulings on an issuer’s initial assessment request(s), or tokens that fall under the relevant clauses in the SRC.

The SEC must qualify whether escrows should be actual entities, or if digital contract escrows can be used

As per the requirement of the Commission, entities conducting token sales under the auspices of the commission must present an escrow agreement from a reputable independent escrow agent as part of its certification process. What PADCDI would like to ask the Commission is if this escrow agreement requires gathered funds to be in the custody of the agent’s wallet(s), or if the escrow agreement can be facilitated by digital contracts.

Smart contract technology allows entities to define and enforce terms with minimal human intervention, and has been used to provide ICOs a means to transparently and securely enforce the terms of its offering. In these cases, it is the participants of the ICO that control the release of funding to the project proponents. There are smart contract technologies available that can monitor the generational history of crypto wallets that can, among other abilities, control the ability of transaction makers and takers using “tainted” or unvetted wallets to interact with companies or each other. The Commission should consider the usage of these self-enforcing contracts as a permissible method of fund escrow.

SEC timelines and default actions for processing of applications must be made more reasonable than provided for in the draft



The passing of RA 11032 or the Ease of Doing Business and Efficient Government Service Act of 2018 provides for the automatic approval of applications for licenses, clearances, permits, or other forms of approval or disapproval.

Per section 7 of the draft regulations, “...the Commission will, within 20 days from receipt [of the initial assessment request], extendable to another 20 days, and as soon as reasonably practicable, after it has received a complete initial application assessment request, assess the nature and complexity of the business model, the team members, and of the products and services which the requester proposed to offer.”

PADCDI understands that the process of reviewing the documentation submitted by every single Initial Assessment Request submitter, as well as the review of every security token ICO registration application will be a daunting task. Within the first few weeks of Thailand opening up to ICOs, the Thai SEC received at least 50 ICO applications with many more expected to follow. PADCDI expects this sort of traffic to follow suit once local regulations are in place, and in light of this, asks the commission to engage PADCDI’s industry members to help in setting up a flow and matrix that the Commission can use to streamline the review and approval process. In line with the modernization of the Commission, PADCDI also hopes for - and would be happy to assist in - the online submission and tracking of initial assessment processes and security token registration process.

The departments that will be handling the review and approval process within the Commission must be specified in the rules

PADCDI recognizes that digital assets, specifically crypto assets and tokens, are a new field that the Commission is starting to embrace and understand. While the association’s members applaud the Commission in letting outside organizations handle the technical review of each company’s applications, PADCDI also recognizes that the Commission will handle many of the review processes within their own group. For transparency, the Commission must define the organizational units - or should the need arise, create a new department composed of qualified individuals - that companies will interact with in the Commission for the purposes of initial review and ICO registration, as well as their specific tasks and timelines within the review and approval process.

A rubric, matrix, or other reasonably quantifiable assessment framework should govern the approval process

While the Commission’s draft enumerates the documentary requirements that every company must provide in relation to their initial review (and if necessary, subsequent application as a registered ICO), the current iteration of the document does not provide for a specific matrix in grading the business model, digital asset model, technical implementation and other review qualifications the Commission will use to benchmark applications.



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PADCDI urges the Commission to go into further detail in describing the specific review principles, standards, and parameters that will be used, including all the artifacts and elements of those artifacts that will be assessed. For example: The qualifications and attributes which differentiate a security token from a utility token should be clearly defined. These qualifications must be expressed in tabular format, ideally in a pass/fail structure that can easily be referenced by both applicants and Commission members, and made available online at all times. Such a method will be consistent with the rules-based approach adopted by the SEC in drafting the ICO rules.

The Commission must release its proposed fee structure for the review and approval process

A concern raised by startup accelerators within the association is that while regulation is good, it should not restrict the ability of newly-created companies and entities to establish their own token offerings. This is particularly true in the unique economic ecosystem of the Philippines, where innovation is stifled by the lack of funding sources available to startups - something that ICOs were meant to address.

To this end, PADCDI asks the Commission to explicitly define and state the proposed fees it intends to levy on prospective ICOs, and to make the review fees accessible to startups and companies that intend to use the funding methodology to accelerate their (legitimate) attempts at innovation.

Overall, PADCDI welcomes the initiative of the Commission to engage and involve businesses and regulators in the creation of a pioneering policy leading to mainstream acceptance of digital assets, crypto assets, and tokens. PADCDI sees the SEC's pioneering actions as the first step towards a future where innovation is accelerated by borderless, secure, transparent, and accessible trading and funding options.

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