ETHICS IN PRACTICE:
Raising Capital with Digital Assets?

CASE STUDY
Munchee is a US-based business that created an iPhone application (App) for users to review restaurants. The company initiated an initial coin offering (ICO) to sell digital tokens to raise $15 million in capital to invest in improving the App. The company advertised and promoted the offering on its website, in a white paper, and on social medial channels and message boards, such as Twitter and Facebook, particularly in forums aimed at those interested in investing in Bitcoin and other digital assets. In the communications about the offering, Munchee said it would use the proceeds to create an "ecosystem" in which the company, its App users, restaurants, and others could use the tokens to buy and sell goods and services. Munchee explained that it expects the tokens to increase in value as a result of the company's efforts. In addition, increased participation in the ecosystem and the use, or "burning," of tokens would also help increase the value of the tokens. Finally, Munchee stated that it intended for the tokens to trade on a secondary market. Munchee's ICO was

A. unacceptable because it promoted a virtual and highly speculative investment unsuitable for investors.
B. unacceptable because it promoted the investment through social media, blog posts, and brief tweets that did not describe the significant limitations and risks associated with buying the tokens.
C. unacceptable because the tokens were an unregistered security under US securities laws.
D. acceptable.
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ANALYSIS

This case involves Standard I(A): Knowledge of the Law, which requires CFA Institute members to "comply with all applicable laws, rules, and regulations ... governing their professional activities." The fact that that the tokens are a virtual currency, highly speculative, and thus unsuitable for many investors does not make it unethical for Munchee to offer them as investments. Munchee is not an investment adviser but an investment issuer. It would be up to investors and their advisers to determine whether an investment was suitable for their portfolio. Similarly, from an ethical standpoint, Munchee is free to promote the tokens in a variety of ways as long as the company provides full and complete information about the investment, responds to inquiries from potential investors, and does not provide any fraudulent or misleading information about the tokens. Munchee can direct those who see brief promotional material about the tokens on social media or Twitter to the company's white paper that presumably contains full and complete information about the tokens. Again, it would be up to an investment adviser, not the issuer, to describe the significant limitations and risks associated with buying the tokens from an investor's perspective.

This case turns on whether the tokens are a security and thus need to be registered according to the US securities laws (US law would applicable because Munchee is a US-based company selling the products in the United States). In its 11 December 2017 cease-and-desist order against Munchee, the US Securities and Exchange Commission (SEC) found that the tokens were securities as defined by Section 2(a)(1) of the Securities Act and must be registered. According to the test applied by the SEC, a product is a security if it involves the investment of money in a common enterprise with a reasonable expectation of profits that are derived from the entrepreneurial or managerial efforts of others. Upon being contacted by the SEC, the company immediately canceled the sale and refunded the money of buyers who had bought tokens. Because of this prompt action and Munchee's cooperation, the SEC imposed no additional sanctions. In this case, the best answer is C because Munchee is a US company that violated US Securities laws. The laws of another jurisdiction may not require registration of this type of virtual currency as a security. In that case, Answer A could be appropriate.