

First Tokenized Index Fund, South Africa

At the end of July 2017, Andrei Danilov, the firm's managing partner, returned from vacation and found himself in the midst of unexpected events. A former colleague approached the firm for legal advice with a request to help a group of applied mathematicians from South Africa conduct an ICO – a public offering of cryptocurrency on the international market. At that time, our company had limited legal expertise in the field of blockchain having only participated in a few crowdfunding projects before. Two months later, the firm was one of the few in the world (this is not a typo) with expertise in ICO, having essentially developed a template for a white paper widely used since then in the market.

Project

There are numerous cryptocurrencies, with their number growing every day. According to a group of young mathematicians from South Africa who came to our firm for advice at the end of summer 2017, the choice of cryptocurrencies for investment was paralyzing. They proposed to solve this problem for crypto investors by creating the world's first tokenized index fund dedicated exclusively to cryptocurrency. The fund's goal was to form a portfolio consisting of the 20 largest cryptocurrencies by market cap using a methodology employed by conventional index funds to populate an index portfolio based on the market capitalization of public companies. It was envisioned that the cryptocurrency fund's portfolio would, like a regular index fund, be adjusted from time to time during the process called rebalancing.

On the Investment Basics

The question of attracting investment usually arises when business creators lack their own resources to develop and bring their product to market. Investments can be attracted in various forms, the main ones being (1) debt financing, (2) equity financing, where an investor acquires a share in the project company in exchange for a monetary contribution to the company's capital, and (3) hybrid form – through convertible debt, where an investor provides a loan but has the right to exchange it for a share in the company under certain conditions.

Debt financing may be affordable for projects which generate sufficiently stable revenue. It is not suitable for startups with merely an idea but no income, with significant operational and capital costs but without a ready-made product for the market. The basic scenario for startups is attracting equity financing or convertible debt.

The next and more important question is where to find investors? Finding an investor on a non-competitive or stagnant market is possible, but there is a high risk of becoming dependent on an anchor investor and its capriciousness, opacity, and nepotism based on family or other grounds. For this reason, a competent startup seeks the most capital-rich, capital-surplus markets in search of investors who are willing, in anticipation of "extraordinary returns," to take on higher risks yet allow a reasonable degree of freedom for the creators of a new business. One such market is the US capital market. So, it sounds simple – go to the US market and find your investor. But this is if, by irony, we do not take into account Newton's Third Law, according to which the force of action, that is, the opportunities opened up by the market, are equal to the force of resistance – powerful regulatory obstacles, which if not taken seriously into account would result in project's failure and lots of legal trouble for sponsors.

Firm's Expertise

Knowing the basic principles of investing and understanding the nexus to the US market, we summarize below the relevant expertise required from our firm for the project. Our firm advised the client, among other things, on (1) securities law issues, in particular on whether the project's token would qualify as a security under the Howey test, (2) all aspects related to project-related intellectual property rights, including trademark registration, (3) the selection of a suitable jurisdiction for the registration of the issuer company, and (4) the preparation of a white paper.

Project Completion

The work on the project required the concentration of efforts of all the firm's lawyers who worked across two continents, drank lots of coffee and didn't particularly like sleeping. In October 2017, the client successfully completed the project and attracted the declared amount of investment as per the white paper needed for the project's development.