

Asset Classification – a Practitioner's View

Prepared for Barac meeting 25/3/2019



Koine

Koine is comprised of experienced professionals from banking, trading & payments sectors that have run regulated market critical infrastructures. Koine provides best practice custody for institutions

- Established in 2017 in the City of London
- UK based team of 35 permanent staff
- Experienced management team from regulated firms
- Provides Digital Custody & Settlement
- Acts as "Agent" not "Principal"
- Authorised as an EMD Agent under the FCA
- Full eMoney Institution licence submitted Dec 2018
- Operating under a Limited Network Exemption
- Delivering bank grade governance & processes
- Operating a "three line's of defence" approach
- Run by an Executive Committee overseen by an Independent board of non-executive directors



Founders & CEO



Phil Mochan
Co-Founder & CCO

Broad experience in TMT & Payment sectors, as business founder, & consultant. Formerly FCA regulated Director of Principal Finance business. Mentor to entrepreneurs, board non-exec with young companies. Debt advisory business to growth Businesses. Computer Engineer, Marketeer & Corporate Financier.



Hugh Hughes
Chairman & CEO

Founder & former CEO & Chairman of Fixnetix. Former CEO of Société Générale in London .



Al Moore,
Co-Founder

Formerly an FCA regulated director of Tullett Prebon Equities & Securities, co-founded Fixnetix in 2007 (Winner of the Deloitte Fast 50 – the fastest growing technology company in the UK in 2011) Technology entrepreneur & non- exec director of multiple tech start-ups

EXCO



Jonathan Smith
CFO (Interim)

Director of Finance & Planning at LCH & member of Group's Finance & Operations. Executive Former Head of Integration Finance at Lloyds Banking Group.



Nic Martin
Managing Director

Former CEO, BFC Bank Completed a bank application process with PRA & established operating model & live governance.



Francesco Roda
CRO/Treasurer

Former Treasurer, Starling Bank Completed a bank application process with PRA. Experienced crypto-currency & blockchain professional. Member of Identity Steering Committee for EEA. Very early investor in cryptos.



Matt Dangerfield
CTO

Former CTO, Fixnetix, Cobalt. Established first private blockchain infrastructure for capital markets. Built & ran market-critical infrastructure. Advisor to Crypto-exchanges.



Jason Mochine
Head of Sales

Over 30 years experience occupying commercial roles at FinTech firms in market data & trading technology such as Citigroup, Reuters, SIX & Fixnetix.



Alex Wilkinson
COO

Former Principle of European Venture Fund COO /CRO, GKFX. GM, Clearing & Execution Services at INTLFCSTONE. Former MD, RBC Global Co-Head Futures & Base Metals. MD, Global Head Listed Derivatives. MD, Dresdner Kleinwort Benson. MD, Fimat Banque Ltd. (Société Générale)



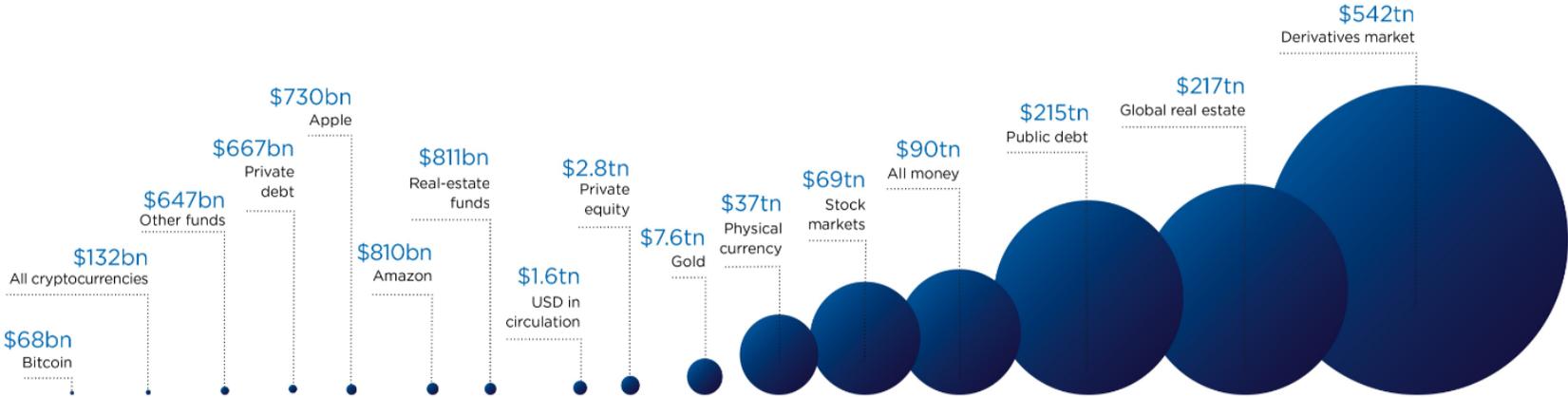
David Grocott
CIO

Former European Head of Connectivity, Global Markets, Deutsche Bank & former Interim COO, Cobalt DLL.

Digital Assets

Blockchain, Digital Ledgers & Tokenisation are expected to transform, the global economy as they allow information to be tracked, unitised & stored in a trustworthy & transparent manner

Institutional investors seek to enter the digital asset marketplace but require secure, independent, custodians regulated & governed to industry standards & wish to minimise counterparty & settlement risk



World Money - January 2019 - Source: Archax

Crypto currencies are just one of the first successful applications of this new technology, they have become an asset class in their own right & we expect there to be whole new markets created through tokenisation



Koine Solution

Offering

Secure Custody

- Providing a separation of duties for institutions
- Digital assets & fiat
- Fully automated process excluding people
- Exchange interoperability

Real-time Settlement

- Sub-millisecond settlement (T+/T+n/DvP)
- Reduced counterparty risk
- Reduced settlement risk
- Privacy of trading activity

Partnerships with Issuers

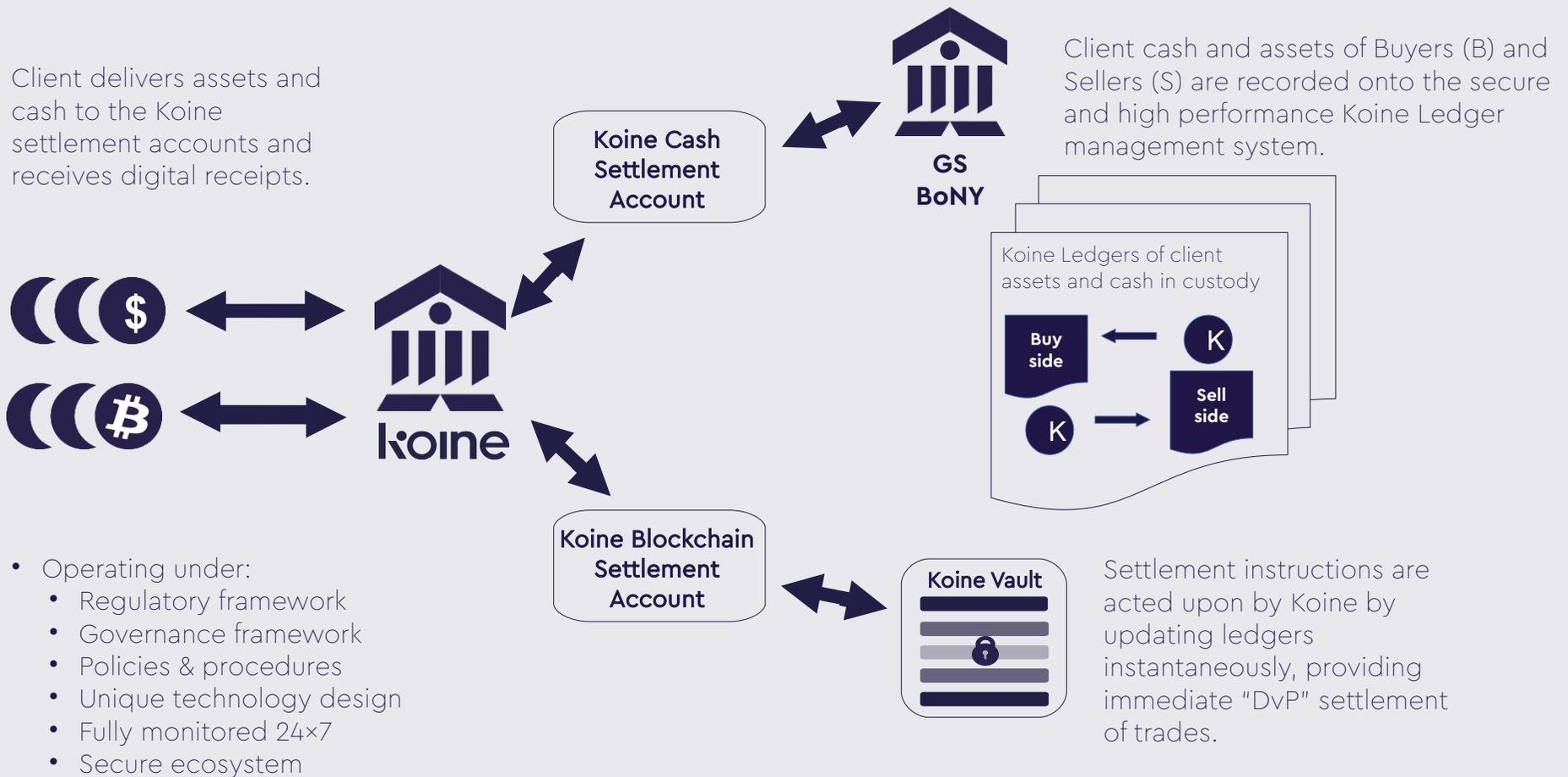
- Bring new issues to market

Serving



Governance and Institutional-grade infrastructure

Clients deposit cash and assets for safekeeping at Koine. These are represented by digital receipts, "K" tokens in the diagram below. Trade instructions, which are placed with and executed by venues, are transmitted to Koine for settlement. Settlement takes place through an update of the ledgers of clients managed by Koine.





Asset Classification

The Koine Digital Asset Risk Register records the internal assessment of risks that the servicing of individual digital assets pose to Koine Money.

Test

- Evaluation of technical and legal characteristics;
- Market recognition
 - CME: Bitstamp, GDAX, itBit and Kraken
 - CBOE: Gemini Exchange;
- FCA Test; and
- Howey Test

Classification

- Centralised or decentralised, i.e.:
 - The rules for the issuance of new tokens
 - The mechanism for the verification of transactions
- Anonymous or traceable;
- Major or minor, i.e. market capitalisation exceeds a given threshold.

The Regulatory Tests

The FCA Test

On Sept. 12, 2017, the UK's Financial Conduct Authority ("FCA") issued a consumer warning on ICOs. The broad categories for their classification were the following:

- Regulated investment;
- A prepayment voucher for future services;
- Token with no discernible value.

Unlike the US, there is no equivalent notion in the UK of investment contracts being securities, and therefore of tokens representing investment contracts also being securities.

From this point of view, tokens which are not explicitly constructed as equity or debt instruments are likely to escape the definition of investments.

The Howey Test

The Howey Test is a test created by the US Supreme Court in 1946 for determining whether certain transactions qualify as "investment contracts". The test:

- It is an Investment of money
- There is an expectation of profits from the investment
- The money invested is in a common enterprise
- Any profit comes from the efforts of a promoter of a third party

The Regulatory Tests, continued

Units in a collective investment scheme test

- Does selling the tokens constitute 'arrangements with respect to property of any description, including money', where the purpose of the investment would be 'to participate in or receive profits or income arising from' a firm's cryptocurrency ventures. This is equivalent to the first and second point of the SEC's Howey Test, i.e. investment of money and expectation of profit.
- Do investors have no day-to-day control over the management of the property, whether or not they have the right to be consulted or give directions? This aligns with the Howey test element of "derived from the managerial efforts of others,"
- Do the token arrangements represent the pooling of multiple investments? They would ordinarily appear to, as its profits are pooled, and the investments are managed wholly by or on behalf of the firm operating the scheme.

The transferable security test (FSMA 2000 definition)

"Anything which is a transferable security for the purposes of Directive 2004/39/EC"

- Do tokens represent shares in companies or other securities equivalent to shares in companies? The notion of "equivalent to shares" is not dissimilar from the collective Howey Test prescriptions.
- Do tokens represent bonds or other forms of securitised debt?
- Do tokens represent any other securities giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures?
- Do tokens represent a derivative contract like an option, swap or future on any instrument falling into the category of transferable securities, including equivalent cash-settled instruments?



Stablecoins

Three types of Stablecoins

- Tokens that are guaranteed by the issuer to maintain parity with a reference fiat currency ; these are intended to facilitate fiat payments for digital assets transactions and referred to as "Centrally Issued Stablecoins".
- Decentralised tokens that are designed to maintain parity with a reference fiat currency; these are referred to as "Decentralised Stablecoins"
- Decentralised tokens that issued on the back of an algorithmic escrow agreement, allowing any user to pledge collateral in return for a stable coin; these are referred to as "Decentralised Collateralised Stablecoin"

Classification

- Type one and three tokens, Centrally Issued Stablecoins and Decentralised Collateralised Stablecoins are akin to securities (IOUs)
- Type two tokens, Decentralised Stablecoins, are not akin to securities as no promise is made on their redemption (indeed, no redemption is possible).

Proof of Stake Crypto

A finance practitioner definition of currencies involves the classical tests (means of payment, of measuring and storing value) and the availability of a risk-free yield – which can be positive.

The forthcoming proof of stake decentralised currencies will pose additional challenges in terms of classification; will these be a new stablecoin breed?