DAO tokens and applicable penalties by CVM

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The Brazilian capital market is regulated by the "*Comissão de Valores Mobiliários*" (Brazilian Securities Commission, or CVM), a federal authority created by Law n° 6.385/76, which sets forth its powers, as well as the rules governing the issuance, distribution, negotiation, and intermediation of securities in the Brazilian market.

Currently, there is no specific rule governing the legal regime applicable to the issuance of DAO tokens, which does not imply that there is no regulation contemplating the subject at all.

Law n° 6.385/76 established under its article 2° a list of the types of securities, delimiting the incidence of capital market rules and the norms established by the CVM. Thus, all items listed under items I to VIII of article 2° of the Law are considered as securities, as well as any other framed by the concept of a collective investment contract, provided under item IX.

Depending on the economic context – how they are issued and the rights they confer to their owners –, tokens may be characterized as collective investment contracts and, consequently, a security, thus being subject to the legislation governing the capital market, including the rules concerning the applicable sanctions by the CVM whenever its rules are violated.

According to Law n° 6.385/76, the CVM may, after an investigation, impose the following penalties to the infringers, singly or in combination: (a) a warning notice; (b) a fine; (c) temporary inability, up to a maximum of 20 years, to exercise the function of manager or member of the fiscal council of a publicly held company, of an entity from the distribution system or other entities relying on the authorization by, or registration with, the CVM; (d) suspension of the authorization or registration for the exercise of the activities dealt with in the Law; (e) temporary inability, up to a maximum of 20 years, to exercise the activities dealt with in the Law; (vi) temporary prohibition, up to a maximum of 20 years, to practice certain activities or operations for the members of the distribution system or other entities relying on the authorization by, or registration with, the CVM; and (vii) temporary prohibition, up to a maximum of 10 years, to act, directly or indirectly, in one or more operation modalities in the securities market.

Resolution n° 160/22 from CVM regulates public offerings distributing securities on the primary and secondary markets and looks for providing a transparent and safe environment for participants. The regulation stipulates that the public offering of securities conducted without the registration or waiver by the CVM is considered a severe infringement, so that further than the fine the infringers may be subject to the penalties of suspension, inability, and temporary prohibition. Furthermore, the regulation provides for the possibility to suspend or cancel the offer.

Concerning the penalty of imposing fines, in November 2017, Law n° 13.506 entered into force, and was further regulated by CVM via the Instruction n° 607/19, currently entitled as Resolution n° 45/21. These rules stipulate, among others, maximum limits for monetary fines, which shall be respected by the CVM whenever an infringement is verified. Hence, the imposed fine cannot exceed the greatest of the following amounts: (a) R$ 50,000,000.00; (b) twice the amount of the irregular issuance or operation; (c) three times the amount of the economic advantage or avoided loss resulting from the infringement; or (d) twice the loss caused to the investors resulting from the infringement.

In addition, Resolution n° 45/21 from the CVM stipulated the maximum amounts for the standards of monetary fines, classifying the administrative infringements in distinct groups according to their gravity. Severe infringements to the rule governing public offerings of securities have the highest of the established amounts and could reach a total amount of R$ 20,000,000.00. It should be noted that such amounts vary according to the aggravating and/or mitigating circumstances of each case.

Despite the absence of specific rules, the CVM has not been inert on the matter. Taking into consideration the wide definition of collective investment contracts, contracts of such nature from the most diverse sectors have already been submitted to CVM's analysis, such as live cattle or condo-hotel contracts.

Specifically concerning DAO tokens, the CVM partially addressed the matter in the administrative proceeding nº 19957.003406/2019-91 from 10.27.2020, in which the federal authority concluded that the token issued constituted a collective investment contract, thus being a security. Consequently, the CVM imposed both the company and the managing partner a monetary fine of R$ 387,934.93, which corresponded to the amount of the irregular issuance.

It is important to mention that, in such cases, because the irregular issuance may also constitute a crime according to art. 7, item II of Law nº 7.492/86, the CVM has the obligation to communicate the fact to the Federal Public Prosecutor for the potential filing of criminal charges.

Therefore, it is essential that, before issuing tokens, the founders conduct a thorough analysis of the requirements provided for under item IX of article 2º of Law nº 6.385/76. If the DAO tokens are considered as collective investment contracts, in accordance with the precedents and the binding legislation, one must pay attention to the rules applicable to securities, especially regarding public offerings. Otherwise, the CVM may hold the issuers accountable according to article 11 of the Law mentioned above.

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