

DAO tokens, collective investment contracts and securities

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DAOs are usually managed by tokens issued by their own treasuries, which may be distributed to its founders and/or members (via airdrops – a non-solicited distribution directly to their wallets) or acquired by members in exchange for fiat currency or other crypto assets (as Ether, for instance). Owning a DAO token regularly means having voting rights on proposals submitted by its members, assisting in the conduction of a governance model, as well as in the decision-making process of the organization.

Before initiating a DAO project, nonetheless, it is crucial for its founders to evaluate whether the governance tokens to be issued by the intended DAO may be considered as securities under the applicable laws, as this would subject them to the regulation from the "Comissão de Valores Mobiliários" (Brazilian Securities Commission, or CVM), especially concerning the characterization of public offerings (and all regulatory consequences deriving from it). Such determination is fundamental, once public offerings of securities are widely regulated by CVM – and subject, in many cases, to mandatory registration with the commission –, being certain that public offerings not in accordance with CVM's regulation may imply severe sanctions to the infringers.

That being said, the determination of whether a governance token from a DAO can configure a security is not necessarily simple. This hardness derives from the fact that, in addition to the types listed under items I to VIII of art. 2º from Law nº 6.385/1976 (such as stocks, debentures, derivatives, and others), securities are also characterized as collective investment contracts, an instrumental and functional concept that encompasses a range of possibilities.

For the analysis of whether governance tokens from a DAO are qualified under this concept, precedents from CVM indicate the necessity to analyze the requirements of the so-called Howey Test – created by the United States Supreme Court in the famous case Securities and Exchange Commission (SEC) v. W. J. Howey Co. –, even if in its tropical version.

According to a recent decision from CVM under the administrative proceeding nº 19957.003406/2019-91, there are 5 (five) central questions that must be answered to analyze the existence of a collective investment contract as a security: "(a) funds were sought from investors by means of a public offering; (b) the investors contributed, or were called upon to contribute, money or other property that may be economically evaluated; (c) the funds raised in the offering, or sought to be raised, were or would be invested in a collective enterprise; (d) the contribution was or would be made in expectation of profit, deriving from a participation right, a partnership or some sort of remuneration (even if resulting from the provision of services); (e) the expected results of the investment would derive, exclusively or mainly, from the efforts of the entrepreneur or third parties?". In case of positive

answers to all of these questions, one would be facing a security, no matter the underlying asset, as far as a collective investment contract is configured by law.

Hence, one of the primordial aspects to determine whether a governance token from a DAO will be, or not, a security is the evaluation of its essential function, which may even depend on the specific category of the DAO in question. Under certain circumstances, tokens from an investment DAO will probably have characteristics much closer to a collective investment contract rather than tokens from a social or philanthropic DAO.

In the United States, for instance, the SEC interpreted that the tokens from The DAO, the first DAO launched on the Ethereum blockchain – which aimed to be an investment DAO – should be considered as securities as all requirements from the Howey Test were met.

In Brazil, although the CVM has not deeply analyzed DAO tokens until this moment, in the administrative proceeding mentioned above, which involved an Initial Coin Offering from “Iconic Intermediação de Negócios e Serviços Ltda.” – that had a DAO structure – the Commission concluded that the token issued by the company configured a collective investment contract, thus being a security and subject to the rules applicable to public offerings, which should have been respected, but as they were not, CVM imposed both the company and its managing partner a penalty of almost R\$ 400,000.00.

Considering the possible and harmful regulatory consequences to the issuer of a collective investment contract that, under the applicable rules, may be considered as a security – thus attracting the rules regarding public offerings – it is extremely prudent that such analysis is carefully made by the entrepreneur before launching a DAO in order to avoid unnecessary risks.

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