

MoFo Guides First SEC-Approved Fund Issuing Digital Tokens

By Reenat Sinay

Law360 (July 6, 2020, 6:13 PM EDT) -- California investment firm Arca, advised by Morrison & Foerster LLP, introduced its Arca U.S. Treasury Fund on Monday, which it says is the first ever U.S. Securities and Exchange Commission-registered closed-end fund to offer digital securities.

The new product will combine innovative technology with the regulatory oversight of traditional finance, according to the company's statement. Investors in the fund will be purchasing digital tokens known as "ArCoin," built on the Ethereum blockchain, which will allow for smoother, faster, cheaper transactions and direct tracking, Arca said.

"Our announcement today is a ground-breaking and transformative step toward the unification of traditional finance with digital asset investing as this new category of regulated, digital investment products is made available to investors," said Arca CEO Rayne Steinberg. "It is truly exciting to be pioneering new digital investment products ... that marry best practices used in traditional finance with the many potential benefits of digital and blockchain technology — this is the next stage of development for the digital ecosystem."

Arca is a Los Angeles-based financial services firm specializing in digital assets and aiming to help investors make the transition to the "digitally-powered global economy of the future," according to its website. ArCoin was developed by the company's product development division, Arca Labs, as the first of several "complementary" digital products in an forthcoming portfolio, Arca says.

After seeking registration with the SEC in the form of various proposals for ArCoin for over 1½ years, the fund is the first to be approved by the agency under the Investment Company Act of 1940, according to regulatory filings.

The vast majority — about 80% — of the fund's assets will be invested in short-term U.S. Treasury securities, the company said. Each ArCoin equals one share of the Treasury Fund, and investors will earn accrued interest each quarter, it added.

"We have seen a dramatic shift in our world from physical to digital during the last several years and an accelerated move toward digital in the last four months amid the COVID-19 pandemic," said Jerald David, president of Arca Capital Management LLC, which oversees Arca Labs. "Furthermore, ArCoin offers enterprises the opportunity to manage their business operations, treasury management and payments with greater efficiency, less cost, faster settlement times and direct tracking of all transactions."

Because the securities will be digital only, they can also be transferred in peer-to-peer transactions using blockchain technology, according to Kelley Howes of Morrison & Foerster.

Some of the regulatory benefits of the fund being registered under the ICA are that it will be overseen by a board of independent trustees, it has adopted a regulatory compliance program and appointed a chief compliance officer, and it's required to provide shareholders with transparency into portfolio holdings every so often, she added.

"That's different than other assets that can be traded using blockchain technology today, and may be attractive to participants in the digital economy," Howes said.

The company envisions investors using ArCoin as a less volatile alternative to other digital assets, and financial institutions employing ArCoin for clearing, lending and payments "in industries where banking has created friction," among other uses, according to its statement.

Interested investors will need to make a minimum purchase of \$1,000 and must complete certain standard documentation before investing.

According to Howes, one of the biggest challenges in navigating regulatory approval for the fund was figuring out the interface between the SEC-registered transfer agent, which keeps shareholder records, and the blockchain record of peer-to-peer transactions.

"Making sure that the respective roles were accurately documented was important not only from a shareholder perspective, but also from a regulatory perspective," she said.

Representatives from the SEC did not immediately respond Monday to requests for comment.

Morrison & Foerster LLP advised Arca, with a team including Kelley Howes, Susan Gault-Brown, Dylan Naughton and Kristofer Readling.

--Editing by Amy Rowe.