
Utility token

This section provides a general explanation of innovative technological trends (DAO, DeFI, NFT, tokens, etc.) that may be related to the provision of financial services or similar activities.

This information does not constitute legal advice or an explanation. We recommend that related parties assess and legally qualify their activities in advance, if necessary, with the help of a professional legal adviser. Consumers of innovative solutions are advised to assess the risks they may be exposed to when using their financial means.

We also recommend that you consult the draft EU Regulation on Markets in Crypto-assets (MiCA) and related proposals.

A utility token is a virtual asset based on distributed ledger technology (DLT) in which investors acquire certain rights from the issuer, who is usually a company or a decentralised organisation. In general, utility tokens are issued to raise money for some project. Thus, the issuance of utility tokens can often draw parallels with some forms of crowdfunding. The rights mentioned, which the ownership of the utility tokens confers on their holders, may include discounts on transactions or exclusive access to a service. At the same time, the utility tokens are generally freely transferable, which is why they are also traded for speculative purposes on various crypto exchanges.

A utility token differs from a security token in that it does not give an ownership stake or an expectation of return in the project issuing it. A security token has a specific underlying asset, for example, in the form of a share in a company, or otherwise qualifies as a security under the Securities Market Act, which also makes it a regulated security under the MiFID and the Securities Market Act (see also the more detailed treatment of [a security token](#)).

Governance tokens, i.e. voting rights in blockchain-based decentralised protocols, can also be classified under the concept of utility tokens. Although such protocols are generally automated, i.e. their day-to-day activities are governed by coded 'smart contracts', a governance mechanism is needed to change the protocol code or decide on new directions for the future. Therefore, a governance token is a type of utility token that entitles its holder to participate in and, under certain conditions, initiate votes on the protocol. Different people may have different amounts of governance tokens, but in general, information about how many governance tokens someone has is public on the protocol.

Legal definition

In the traditional sense, the Estonian Law of Obligations Act applies to a utility token, which gives the investor a certain right to receive certain preferential rights or benefits from the issuer in the future. This is because utility tokens are essentially a partial or full advance payment for services or products. For more information on the ICOs to which the Law of Obligations Act applies, [see the relevant information text](#) provided by the Finantsinspektsioon.

If a company decides to issue a token, which they themselves call a utility token because of the non-monetary benefits of acquiring it, but which also gives, for example, an expectation of income in that company, then it qualifies as a security. In such a case, the terms of the offering also require an analysis of the necessity to register, file, and disclose the prospectus or information document.

Utility tokens issued by Decentralized Autonomous Organizations (DAOs), under which they also have their governance tokens, are currently not regulated in Estonia or elsewhere in the European Union. As a result, there is also no legal protection for those investing in them, and particular care must be taken when investing in them.

In the future, utility tokens will also be regulated by the EU Regulation on Markets in Crypto-assets (MiCA). According to the European Commission's proposal, a utility token is 'a type of crypto-asset which is intended to provide digital access to a good or service, available on DLT, and is only accepted by the issuer of that token'. Among other things, the MiCA will set out requirements for a white paper on utility tokens, which will have to describe in detail the terms of the offering.

Risks

Cyber risks – Situations are possible where the project that issued the utility tokens is disrupted, either because of errors in its 'smart contracts' or because of cyber attacks against it. Currency theft from an investor's virtual wallet can also occur. As the protocols that issue the utility tokens are based on the blockchain, the threats inherent in the blockchain, such as 51% of the validators and outside attacks, and other disruptions to its operation are also relevant. Investors should bear in mind that any complications relating to the underlying system of the utility token may reduce its market value.

Project risk associated with a utility token – the issuer of a utility token is presumed to have an obligation to provide certain services or rights to the investor in return for its ownership. However, there may be situations where the company or organisation that issued the token is unable to meet its obligations or goes out of business. Therefore, before purchasing a utility token, it is important to verify the reliability of the provider.

Volatility of a utility token as a currency – Like other cryptocurrencies, the market price of utility tokens is highly volatile. This can be influenced by the overall market situation, as well as by the underlying project of the utility token. For example, a situation where a token issuer fails to provide a promised service to its own investors could lead to a fall in the token price.

Future of utility tokens

Thanks to the possibility of raising money for projects in return for a range of future rewards for investors, utility tokens are already an attractive solution for many. However, the protection of consumers in the event of a token provider failing to meet its promised obligations (especially in the event of a decentralised blockchain-based organisation) remains unclear. There are also no uniform rules on the publication of offering information. However, following the establishment of a clearer legal framework, which the EU MiCA Regulation will do in the future, the utility token could have the potential to develop into an even more widely accepted and used way of engaging money on digital platforms.

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