

Token Safe Harbor Proposal
Office of Commissioner Hester M. Peirce
February 6, 2020

Proposed Securities Act Rule 195 – Time-limited Exemption for tokens.

Preliminary Notes:

1. Distributed ledger technology may be used to offer and sell digital assets, such as tokens, to raise capital and for other purposes. The U.S. federal securities laws may apply to such transactions, depending on the particular facts and circumstances, without regard to the form of the organization or technology used to effectuate a particular offer or sale.

The analysis of whether a token is offered or sold as a security is not static and does not strictly inhere to the digital asset. A token may be offered and sold initially as a security because it is wrapped in an investment contract, but that designation may change over time if the token is later offered and sold outside of an investment contract. For example, a token sale may no longer be the sale of an investment contract if purchasers could no longer reasonably expect a person or group to carry out the essential managerial or entrepreneurial efforts.

However, in order for a network to mature into a functional or decentralized network that is not dependent upon a single person or group to carry out the essential managerial or entrepreneurial efforts, the tokens must be distributed to and freely tradeable by potential users, programmers, and participants in the network. Additionally, secondary trading of the tokens typically provides essential liquidity for the development of the network and use of the token. The application of the federal securities laws to these transactions frustrates the network's ability to achieve maturity and prevents the transformation of the token sold as a security to a non-security token functioning on the network.

Accordingly, this safe harbor is intended to provide Initial Development Teams with a three-year time period within which they can facilitate participation in, and the development of, a functional and/or decentralized network, unrestrained from the registration provisions of the federal securities laws so long as the conditions are met. The safe harbor is also designed to protect token purchasers by requiring disclosures tailored to the needs of the purchasers and preserving the application of the anti-fraud provisions of the federal securities laws.

Upon the conclusion of the three-year period, the Initial Development Team must determine whether token transactions involve the offer or sale of a security. Token transactions may not constitute securities transactions if the network has matured to a functioning or decentralized network. The definition of Network Maturity is intended to provide clarity as to when a token transaction should no longer be considered a security.

transaction but, as always, the analysis will require an evaluation of the particular facts and circumstances.

2. *Rule 195 is not an exclusive safe harbor. A person who does not meet all of the applicable conditions of Rule 195 still may claim any other available exemption under the Securities Act of 1933 for the offer and sale of the securities.*

(a) Exemption. Except as expressly provided in paragraph (d) of this section, the Securities Act of 1933 does not apply to any offer, sale, or transaction involving a token, as defined herein, if the following conditions are satisfied by the Initial Development Team, as defined herein.

- (1) The Initial Development Team intends for the network on which the token functions to reach Network Maturity, as defined herein, within three years of the date of the first sale of tokens and will undertake good faith and reasonable efforts to achieve such status;
- (2) Disclosures required under paragraph (b) of this section must be made available on a freely accessible public website.
- (3) The token must be offered and sold for the purpose of facilitating access to, participation on, or the development of the network.
- (4) The Initial Development Team intends to and will undertake good faith and reasonable efforts to create liquidity for users. If the Initial Development Team attempts to secure secondary trading of the token on a trading platform, it will seek secondary trading platforms that can demonstrate compliance with all applicable federal and state law and regulations relating to money transmission, anti-money laundering, and consumer protection.
- (5) The Initial Development Team files a notice of reliance in accordance with paragraph (c) of this section.

(b) Disclosure. The Initial Development Team must provide the information described below on a freely accessible public website. Subsequent to the date of filing the notice of reliance pursuant to paragraph (c) of this section, any material changes to the information described in subparagraphs (1-4), (6), and (7) below and the information described in subparagraph (8) must be provided on the same freely accessible public website as soon as practicable.

- (1) *Source Code.* A text listing of commands to be compiled or assembled into an executable computer program used by network participants to access the network, amend the code, and confirm transactions.
- (2) *Transaction History.* A narrative description of the steps necessary to independently access, search, and verify the transaction history of the network.

(3) *Token Economics.* A narrative description of the purpose of the network, the protocol, and its operation. At a minimum, such disclosures should include all of the following:

- (i) Information explaining the launch and supply process, including the number of tokens to be issued in an initial allocation, the total number of tokens to be created, the release schedule for the tokens, and the total number of tokens outstanding;
- (ii) Information detailing the method of generating or mining tokens, the process for burning tokens, the process for validating transactions, and the consensus mechanism;
- (iii) An explanation of governance mechanisms for implementing changes to the protocol; and
- (iv) Sufficient information for a third party to create a tool for verifying the transaction history of the token (e.g. the blockchain or distributed ledger).

(4) *Plan of Development.* The current state and timeline for the development of the network to show how and when the Initial Development Team intends to achieve Network Maturity.

(5) *Prior Token Sales.* The date of sale, number of tokens sold, any limitations or restrictions on the transferability of tokens sold, the amount raised, and the type of consideration received.

(6) *Initial Development Team and Certain Token Holders.* Furnish the following information.

- (i) The names and relevant experience, qualifications, attributes, or skills of each person who is a member of the Initial Development Team;
- (ii) The number of tokens or rights to tokens owned by each member of the Initial Development Team and a description of any limitations or restrictions on the transferability of tokens held by such persons; and
- (iii) To the extent members of the Initial Development Team have a right to be rewarded tokens in the future in a manner that is distinct from how any third party could obtain tokens, describe how such tokens may be rewarded.

(7) *Trading Platforms.* Identify secondary trading platforms on which the token trades, to the extent known.

(8) *Sales of Tokens by Initial Development Team.* Each time a member of the Initial Development Team sells five percent of his or her tokens as disclosed pursuant to

paragraph (b)(6)(ii) of this section over any period of time, state the date(s) of the sale, the number of tokens sold, and the identity of the seller.

(c) Filing of Notice of Reliance. The Initial Development Team offering or selling tokens in reliance on Rule 195 must file a notice of reliance on the safe harbor no later than 15 calendar days after the date of the first token sold in reliance upon the safe harbor, unless the end of that period falls on a Saturday, Sunday or U.S. federal holiday, in which case the due date would be the first business day following.

(1) The notice must contain the following information:

- (i) Names of the Initial Development Team, including each individual member;
- (ii) Date of the first token sold in reliance upon the safe harbor;
- (iii) Attestation by a person duly authorized by the Initial Development Team that the conditions of this section are satisfied; and
- (iv) The website where disclosure required under paragraph (b) may be accessed.

(2) The Initial Development Team must file an amendment to a previously filed notice to reflect a material change in the information provided, as soon as practicable after the change.

(3) A notice of reliance must be filed with the Commission in electronic format by means of the Commission's Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) in accordance with EDGAR rules set forth in Regulation S-T.

(d) Limitation. The exemption provided in paragraph (a) of this section does not apply to the provisions of Section 12(a)(2) or Section 17 of the Securities Act of 1933.

(e) Duration of Exemption. The relief provided by this section will expire three years from the date of the first token sold in reliance upon the safe harbor. If the Initial Development Team is relying upon paragraph (f) of this section, the exemption will expire three years from the date of the filing of a notice of reliance by the Initial Development Team.

(f) Tokens Previously Sold. Tokens previously sold pursuant to a valid exemption from registration may rely upon this section if the conditions of paragraph (a)(1), (2), (4), and (5) are satisfied. The notice of reliance required by paragraph (c) of this section must be filed as soon as practicable.

(g) Definition of Qualified Purchaser. For purposes of Section 18(b)(3) of the Securities Act of 1933, a "qualified purchaser" means any person to whom tokens are offered or sold pursuant to reliance on paragraph (a) of this section.

(h) Disqualifications. No exemption under this section shall be available for the tokens of any Initial Development Team if it or its individual members would be subject to disqualification under Rule 506(d).

(i) Definitions.

(1) *Token.* A token is a digital representation of value or rights

- (i) that has a transaction history that:
 - (A) is recorded on a distributed ledger, blockchain, or other digital data structure;
 - (B) has transactions confirmed through an independently verifiable process; and
 - (C) resists modification or tampering of the transaction;
- (ii) that is capable of being transferred between persons without an intermediary party; and
- (iii) that does not represent a financial interest in a company, partnership, or fund, including an ownership or debt interest, revenue share, entitlement to any interest or dividend payment.

(2) *Initial Development Team.* Any person, group of persons, or entity that provides the essential managerial efforts for the development of the network prior to reaching Network Maturity.

(3) *Network Maturity.* Network Maturity is the status of a decentralized or functional network that is achieved when the network is either:

- (i) Not controlled and is not reasonably likely to be controlled or unilaterally changed by any single person, entity, or group of persons or entities under common control; or
- (ii) Functional, as demonstrated by the ability of holders to use tokens for the transmission and storage of value, to prove control over the tokens, to participate in an application running on the network, or in a manner consistent with the utility of the network.

The definition is not meant to preclude network alterations achieved through a predetermined procedure in the source code that uses a consensus mechanism and approval of network participants.

Proposed Exchange Act Rule 3a1-2. Exemption from the definition of “exchange” under Section 3(a)(1) of the Act.

An organization, association, or group of persons shall be exempt from the definition of the term “exchange” to the extent such organization, association, or group of persons constitutes, maintains, or provides a market place or facilitates bringing together purchasers and sellers of tokens satisfying the conditions of Rule 195 of the Securities Act, or otherwise performs with respect to such tokens the functions commonly performed by a stock exchange as that term is generally understood.

Proposed Exchange Act Rule 3a4-2. Exemption from the definition of “broker” for a person engaged in a token transaction.

A person is exempt from the definition of the term “broker” to the extent it engages in the business of effecting transactions in tokens satisfying the conditions of Rule 195 of the Securities Act of 1933 for the account of others.

Proposed Exchange Act Rule 3a5-4. Exemption from the definition of “dealer” for a person engaged in a token transaction.

A person is exempt from the definition of the term “dealer” to the extent it engages in the business of buying and selling tokens satisfying the conditions of Rule 195 of the Securities Act of 1933 for such person’s own account through a broker or otherwise.

Proposed Exchange Act Rule 12h-1(j). Exemptions from registration under Section 12(g) of the Act.

Issuers shall be exempt from the provisions of section 12(g) of the Act with respect to the following securities:

New paragraph (j):

- (j) Any token offered and sold in reliance on Rule 195 of the Securities Act of 1933.