

Token Securities Framework & Launching a Network

SPEAKER

Brian Brooks, Former Chief Legal Officer, Coinbase

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Brian Background



COINBASE
Chief Legal Officer



FANNIE MAE
Board of Directors

Previously
Executive Vice President,
General Counsel,
Corporate Secretary



**CALIFORNIA
BANKERS
ASSOCIATION**
Board of Directors,
Executive Committee



**SPRING LABS,
FLYHOMES, EARNUP,
GRASSHOPPER BANK
AND TEXTIQ**
Early stage
investor/advisor

Agenda

Regulatory Background: Tradeoffs and Opportunities

Is Being a Security Really That Scary

Crypto Rating Council

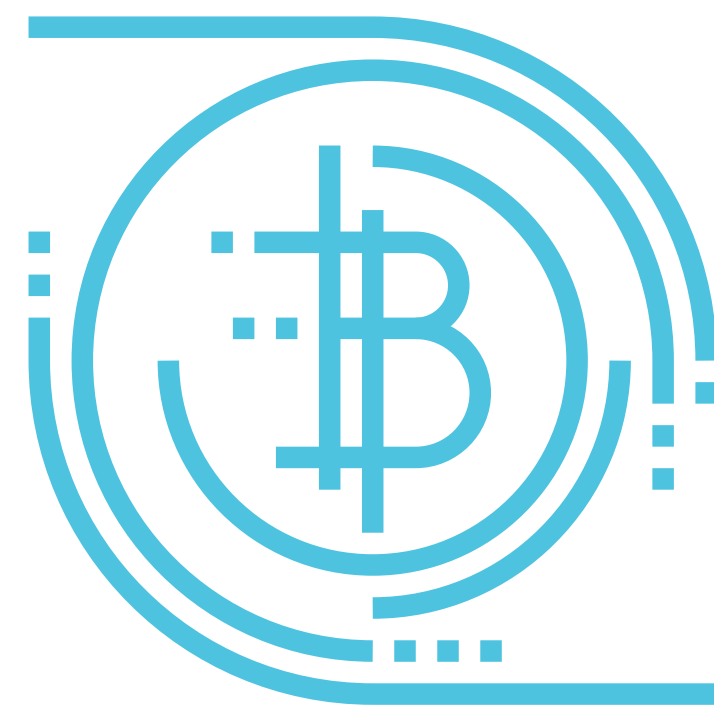
Tradeoffs in Your Business Strategy?

Now and Later

The choices you make in the design phase now will have significant consequences for:



Operate
Network



Fundraise
Token



Go Public
Company

Keep in Mind

The choices you make now may not be the choices you'll make later.

Digital Asset Regulation



Treasury

FinCEN

- Bank Secrecy Act
- Anti-Money Laundering
- Counter-Terrorism Financing

OFAC

- Specially Designated Nationals

IRS



SEC

Regulation and oversight of securities industry, including exchanges, broker-dealers, investment advisors, mutual funds, and public companies



CFTC

Trading of futures, swaps, and other derivatives, including commodity tokens



International Jurisdictions

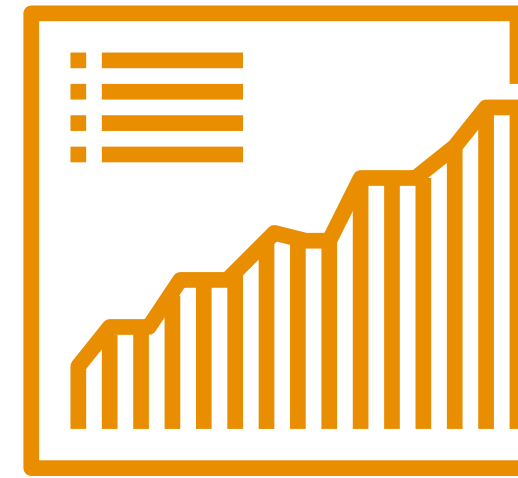
- European Union
- Singapore
- Japan

Why Do the Securities Laws Care About Your Token?

The securities laws care about what an investor is entitled to know



MD&A



Financial Statements



Governance



D&O



Risk Factors

Keep in Mind

If the value of your token is contingent upon your success, then it's a security.

When you are raising money, the vehicle you use may be a security.

Howey Test

- SEC v. W.J. Howey (1946): Citrus grove tracts in Florida
- The Supreme Court defined “investment contract”
 - An investment of money
 - In a common enterprise
 - With an expectation of profit
 - Solely from the efforts of others
- Uncertainty: How does it apply to each case?

Safe Harbor Proposal

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 a transaction involving 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 users of the network and aids in the development of the network. 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 or decentralized network, exempt 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. always, the analysis will require an evaluation of the particular facts and circumstances.

2. Rule 195 is not an exclusion
195

Crypto Rating Council

Purpose

Framework

Scoring



CRC Score Card

Digital Asset Review Questions	Answers	Howey Prongs			
		Investment of Money	Common Enterprise	Reasonable Expectations of Profits	Efforts of Others
1. Did purchasers contribute fiat or digital currency in exchange for tokens, excluding secondary purchases through a platform which are not from the Project Team ³ ? If a Project Team both (i) conducted a substantial pre-mine and (ii) sold pre-mined tokens to fund its operations, indicate “Yes”.	YES	+100			
	NO	0			
	N/A	0			
2. If the answer to #1 is No, did token holders contribute services or other individual efforts that support the system/network (e.g., proof of work mining) in exchange for tokens?	YES	+50 ⁴			-20
	NO	0			0
	N/A	0			0
3. If the answer to #1 and #2 are No, were token holders required to provide email addresses, KYC information, wallet information or other non-monetary consideration that could have value to the Project Team in exchange for tokens?	YES	50 ⁵			
	NO	0			
	N/A	0			

A **score of 1** - few or no characteristics consistent with treatment as a security.

A **score of 5** - asset has many characteristics strongly consistent with treatment as a security.

The following are all possible scores from the framework: 1, 2, 3, 3.5, 3.75, 4, 4.25, 4.5, 4.75, 5.

CRC Score Card

1	3 prongs have scores below 100
2	2 prongs have scores below 100
3	1 prong has a score below 100, and no prong is above 150
3.5	3 prongs are 100 or greater, and one or more prongs is above 150 but below 200
3.75	3 prongs are 100 or greater, and either (1) the 4th prong is 75 or above; or (2) one of the other 3 prongs is 200 or greater
4	All 4 prongs are 100 or greater, but no prong is above 150
4.25	All 4 prongs are 100 or greater, and no more than one prong is above 150
4.5	All 4 prongs are 100 or greater; two prongs are above 150, or one prong is above 200
4.75	All 4 prongs are 100 or greater; three prongs are above 200, or one prong is above 250
5	All 4 prongs are 100 or greater; three prongs are above 250, or one or more prong are above 300

Security or Not a Security?

2 things to consider

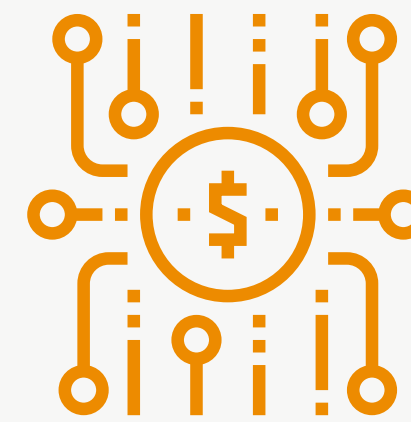
WHAT are you distributing



Your token might or might not be a security

VS

HOW are you distributing



The manner you distribute may be a securities offering

Exempt Offerings:
Reg D, Reg A+
Crowdfunding

Crypto Offerings:
ICO, IEO, STO

Keep in Mind: The CRC Score Card is a new tool to help you answer this question.

Fundraising, Functionality, Some Blend (Oh my!)

What are you trying to do?

Functionality

- Priority is to sell a service
- Trading and Liquidity less important
- Pricing and volume is tied to utility

Score: ~1

Fundraising (Fully-operational project)

- Priority for trading and liquidity
- Already decentralized and open-sourced
- Asset value and marketing is independent of project team's involvement
- Asset is necessary for functioning of network
- Asset does not pay dividends

Score: ~2

Fundraising (Work in progress)

- Priority for trading and liquidity
- Not fully decentralized
- Dev team involvement is material
- Imperfect marketing
- No staking, or no requirement to stake

Score: ~3.5

Seed Users

- Priority is to seed large network of users
- Assets distributed for free
- Dependent on dev team
- Minimal development
- Avoids marketing faults

Score: ~3.75

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Functionality

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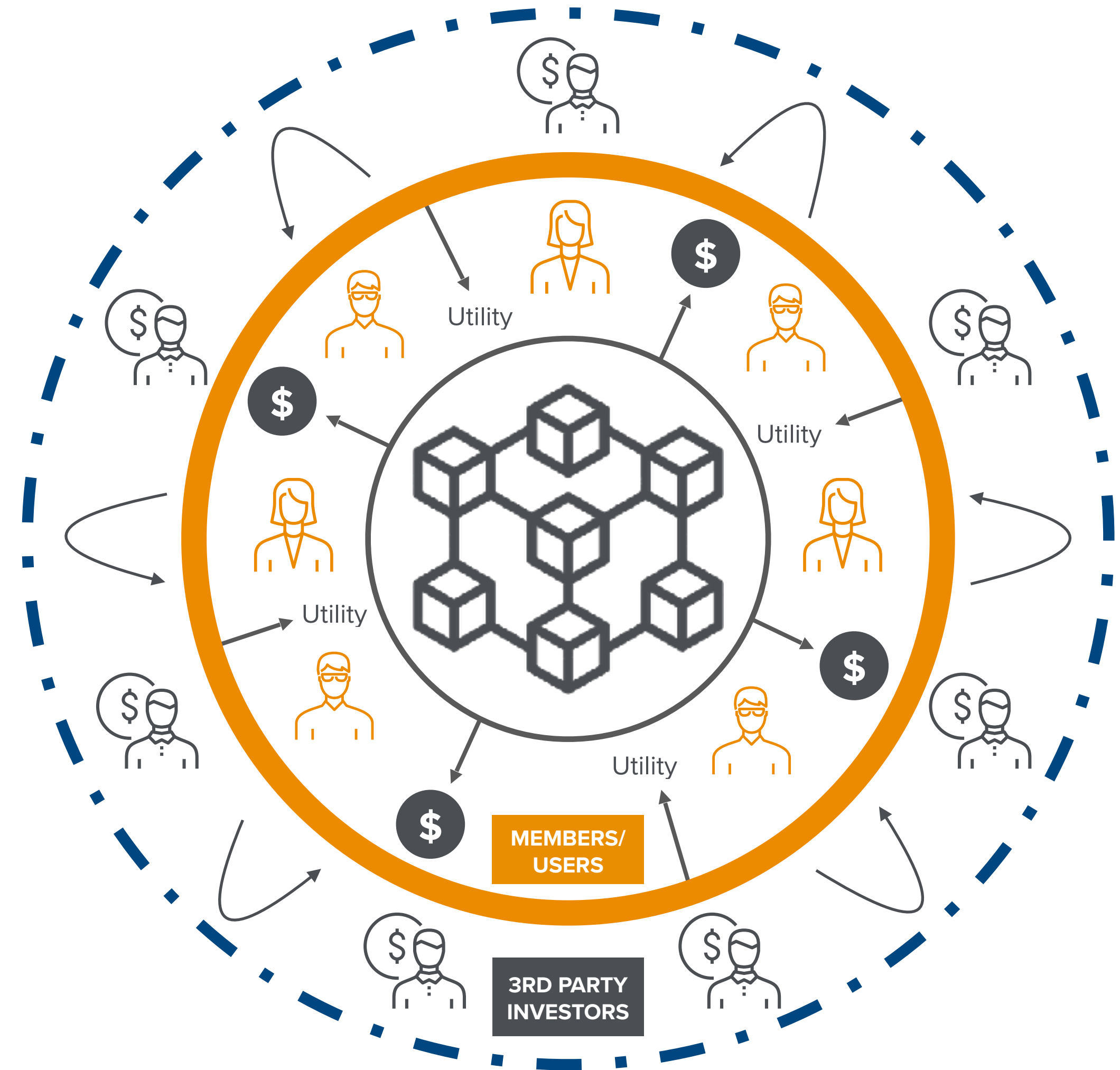
Fundraising, Functionality, Some Blend (Oh my!)

What are you trying to do?

Membership

- Priority is access to users without access to traditional capital markets
- Tokens represent membership interest in non-stock entity
- Limited transferability
- Expectation of dividends derived by in-network worth

Score: **Untested**



Familiar Membership Models



Member pays one-time \$20 lifetime membership fee

- 10% annual dividend on your purchases
- Vote for Board of Directors
- Access to members-only designs and sales
- Events and classes at members-only discounted prices
- Stores all your receipts with your account for returns and exchanges



**Northwestern
Mutual®**

Premiums based on age and coverage

- No private stockholders; policyholders share stock
- Has paid out dividends to policyholders each year since 1872
- Held #1 spot for premiums written in last four years (more premiums, increased opportunity for dividends)
- Each member is entitled to one vote regardless of coverage



Equity investment of 5.5 percent of annual income

- Profits are returned to the farmers, employees, and community through an established formula
- Member-farmers elect the Board of Directors
- Farmers also make up a separate executive committee
- Stable pay price that has been above the commodity price
- Veterinary support and access to feed and forage

Hot Button Topics



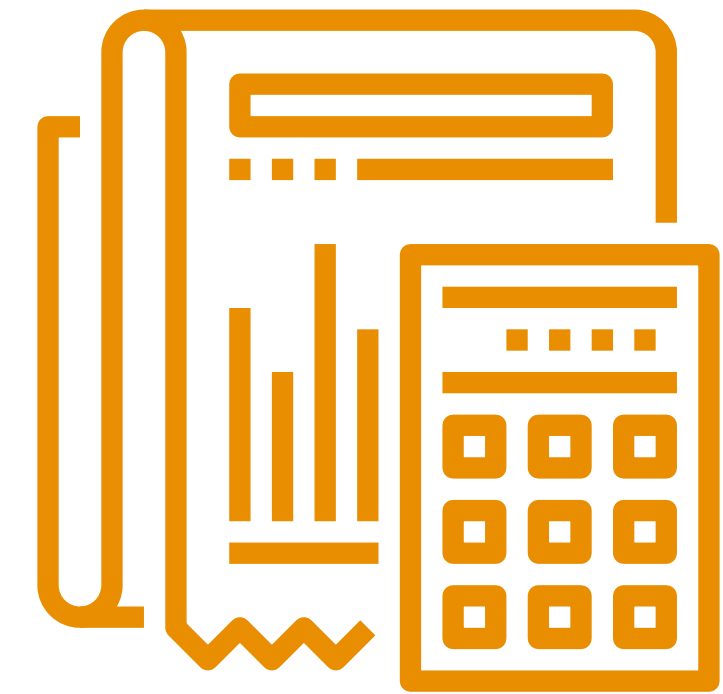
**Gambling
Tokens**



**Privacy
Tokens**



**FATF
Regulations**
(black and white
markets)



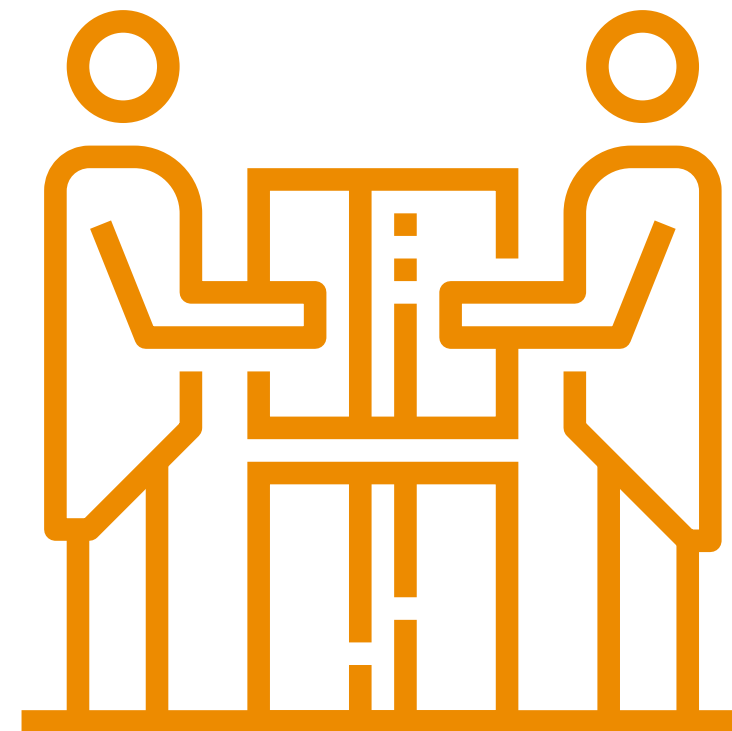
**Tax
Reporting**

Help Is Available!

Come start a conversation with the Coinbase Launch team



Engage with advisors **early in your development process**



Receive counsel on your project:
what could contribute to a subsequent
positive securities law analysis

All crypto projects,
not just future
Coinbase listings

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[CRYPTO STARTUP SCHOOL]