# REGULATION X PROPOSAL

AN EXEMPT OFFERING FRAMEWORK FOR TOKEN ISSUANCES

APRIL 25, 2022

LEXPUNK DRAFT – FOR DISCUSSION PURPOSES

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In this document, LeXpunK[1] proposes an exempt offering framework for certain digital assets (which we call "**Reg X**") that incorporates elements of Regulation A, as modified by Section 401 of the Jumpstart Our Business Startups Act (the "**JOBS Act**") and Section 4(a)(6) of the JOBS Act ("**Reg CF**").

## I. Purpose and Overview

The invention of blockchain technology has inspired a proliferation of developments in decentralized computing, finance, and governance. However, Federal securities laws – which are predicated on rigidly-defined corporate structures, intermediated capital markets, and centralized points of control – have not kept pace with these developments.

Under the traditional centralized models of doing business ("**TradFi**"), business enterprises are intended to operate in a centralized, hierarchical fashion, with corporate directors and management acting as fiduciaries for shareholders. When these entities raise capital, there are significant risks that the existing regulatory regime addresses appropriately.

However, in the new realm of decentralized operating models, there is no corporate form, no directors, and no shareholders. Users act in concert, not through direct coordination, but in a decentralized fashion according to their independent judgments and in response to incentive structures embodied in software code. Because of the high degree of user involvement, the self-custody and peer-to-peer ("**P2P**") transferability of digital assets, and the absence of formal legal entities and fiduciary relationships, the risks entailed by these forms of governance are entirely different and existing securities law frameworks do not adequately address these risks.

Every new protocol is at its most centralized at inception, which will inherently give rise to certain risks mirroring those of TradFi for so long as elements of centralization persist; therefore, shedding these elements is of paramount importance. Even Bitcoin, now considered a decentralized, autonomous protocol, began as the brainchild of a single person (or perhaps a small group) writing under the pseudonym "Satoshi Nakamoto". For the first few months of its operation, Satoshi was the only active developer and the only "miner" on the Bitcoin network. Eventually, however, Satoshi quietly abandoned all activity, leaving Bitcoin as a fully autonomous, self-governing system. Similarly, the Ethereum blockchain, although financed by an "initial coin offering", is now regarded as sufficiently decentralized to the point where the securities laws are no longer applicable to its native token.

[1] LeXpunK is an informal association of attorneys dedicated to advocacy on behalf of blockchain software developers. LeXpunK attorneys direct their efforts toward (i) formulating and advocating for clear and well-tailored policies and regulation to achieve important public policy objectives while protecting the values of openness, transparency, and decentralization; and (ii) developing model legal standards, structures and best practices for the digital asset ecosystem. LeXpunK is founded on the belief that lawyers have both a role and duty to contribute to the open source movement. LeXpunK is supported with grant funding from the Yearn, Curve and Lido protocols, but does not represent any individual or entity.

Perhaps the greatest paradox of the existing regulatory regime is that digital assets constitute "investment contracts" to the extent they are centralized – but this designation imposes restrictions on issuance and trading that all but guarantee continued centralization. An unfortunate consequence is that there is no viable path to compliance; rather, the industry norm has been to attempt to "fly under the radar" in the hopes of achieving "sufficient decentralization" before attracting regulatory scrutiny. We are concerned that this environment impedes capital formation, chills innovation, undermines the rule of law, and creates an environment that draws no distinctions between good and bad actors while allowing bad actors to perpetrate fraud.

We believe there is significant value for regulators in showing the market the benefits[2] of compliance efforts. We therefore propose a new exempt offering framework for certain digital assets, Reg X. We believe that Reg X offers a viable path to compliance via decentralization. One of the key goals of Reg X is to achieve a wide distribution of digital assets that fall within the framework and to pass control of protocols from their initial development teams to the broader community as quickly as possible.

While this framework is not intended to address all the complexities of how U.S. securities laws could interact with digital assets, it provides a way for issuers seeking to distribute Tokens (as defined below) by "opting-in" to the use of a new Federal exempt offering framework. The Reg X offering exemption and secondary market disclosure framework could enable the public policy framework of securities laws to extend to issuances of Tokens in a way that:

> (i) facilitates capital formation and enables peer-to-peer transactions by enacting certain key modifications to laws around exempt securities offerings while minimizing arbitrage opportunities for issuers;
>
> (ii) retains the focus on issuer disclosures while adjusting such disclosures where necessary to interact with the particularized risks posed by these models;[3]

[2] From a policy perspective, there are significant rule of law gains to be had by regulators in showing compliance is possible. We specifically reference Props and Stacks as examples that can be learned from and built upon in this proposal.

[3] While this proposal is by no means fully polished, our goal is to start a dialogue about how regulators could create common sense rules to harmonize a framework for certain token issuances with existing securities laws, drawing from existing rules and definitions where possible. As such, in this proposal, we have diverged from existing rules only where we feel it is not appropriate to apply existing rules to this model (i.e. it is impractical or creates needless friction while not serving a regulatory need). We also wish to ensure any proposal (i) fairly distributes compliance obligations in the market, cognizant of the interaction between an issuer, the development team, insiders, large holders and Tokens and (ii) provides adequate disclosure around the risks posed by non-aligned incentives between the same, together with new risks and opportunities that arise from the model, including risks posed by the technology and the benefits, including removal of the need for transfer agents. We believe that some of the competing proposed regulatory models for token issuances place an undue burden on issuers while allowing secondary market actors to avoid all oversight and compliance responsibility.

(iii) clarifies what types of Token issuances fall beyond the securities laws, subject to certain conditions;[4]

(iv) mandates secondary markets disclosure with a focus on (i) insiders, (ii) points of control and centralization and (iii) actors with large holdings in the market, while retaining traditional securities law focus on ongoing issuer reporting obligations, protections for retail investors, and enforcement against bad actors;[5] and

(v) attempts to harmonize how these assets and this disclosure regime interacts with existing securities laws and disclosures, including when a Token offering might implicate a registration of an Issuer's equity under Section 12(g) of the Exchange Act.

Under the Reg X "opt-in" framework, Issuers that meet eligibility requirements ("**Reg X Issuers**") may conduct issuances of Tokens ("**Reg X Offerings**"), subject to the requirements described herein.[6] Reg X Issuers would be required to provide in their offering documents disclosures including the terms of any non-public distributions of the Tokens made to date, any related party transactions (similar to an Item 404 standard) and the source code governing the operations of the Tokens.[7] Fundraising portals, analogous to those of Reg CF offerings, would be responsible for ensuring compliance with these disclosure requirements. For those projects that reach a level of decentralization that mirrors the requirements of our proposed Safe Harbor, we have included an off-ramp for issuer reporting.[8] Unless and until Reg X issuers are eligible to file an exit report, they would be required to file annual, semiannual, and current reports with

[4] Clarification on the limits of the securities laws is an important element of the proposal. Our approach to defining the limits of the securities laws is to integrate an updated version of the safe harbor originally proposed by Gabriel Shapiro (hereinafter, the "**Proposed Safe Harbor**") and involves disclosure/notice of a project's use of the safe harbor for regulatory awareness. The Proposed Safe Harbor is available at: https://github.com/lex-node/SafeHarbor-X/ (last updated January 8, 2022).

[5] In addition to bad actor disqualifications as a bar to an offering, by virtue of availing themselves of securities offering framework, issuers will subject themselves and Token issuances and resales to the antifraud provisions of federal securities laws.

[6] We do not address the implications of the recent Regulation ATS proposed amendments. Although we find the proposed amendments to be a disturbing overreach, we wish to bypass any ongoing debates over whether any such tokens are intrinsically securities, as opposed to assets being offered through a securities framework. We believe that providing a degree of certainty, including a compliant path forward, around tokens offered as an investment contract and delineating the implications on any further issuances is paramount. There is an ongoing ideological debate that may eventually be settled, but our goal here is to provide a regulatory incentive for projects to opt-in, choose this framework and in return, fulfill policy goals of solving information asymmetry.

[7] Rather than prescribe standards for audits of source code, we expect that these standards would emerge organically as portal establish their own requirements. These portals have a vested interest in quality control and mitigating reputational risk.

platforms will establish requirements for code audits.

[8] We think that this part of our proposal appropriately harmonizes the Safe Harbor with an off-ramp when the Issuer is no longer an appropriate party or knowledge group to make disclosures on behalf of a decentralized project.

the Commission on an ongoing basis. Regardless of whether the issuer continues reporting, we envision certain continued and ongoing secondary market disclosures by market actors.

We expect that many Reg X issuers will never become eligible to file an exit report. These issuers are colloquially referred to as "decentralized in name only", having the superficial trappings of decentralized systems (such as Tokens conveying nominal governance rights) while retaining significant control over key elements.[9] An ongoing reporting and disclosure regime is appropriate in this context.

If there is interest in a continued conversation, we plan to revise this draft, incorporating feedback and adding as an exhibit a mark-up of modified disclosures that could apply to the risks posed by this paradigm with a comparison to existing Reg A requirements.[10]

## II. Definitions.[11]

- **Affiliate** means a Person that directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the Issuer.
- **Autonomous Code** means the Code operating on one or more Autonomous Networks.
- **Autonomous Cryptosystem** means: (a) the combination of a particular Autonomous Network and an Open Ledger maintained thereby; or (b) the combination of particular Autonomous Code, a particular Open Ledger on which the Autonomous Code is verifiably stored and a particular Autonomous Network which maintains such Open Ledger and executes such Autonomous Code.
- **Autonomous Network** means a Network that does not depend for its continuing operation or availability on, and is not owned, controlled or arbitrarily modifiable by, any single person or single group of Extrinsically Affiliated Persons.
- **Autonomous Token** means any Token operating on an Autonomous Cryptosystem that (i) enables the user, through the operation of the relevant Autonomous Cryptosystem, to: (1) pay for the use of an Autonomous Cryptosystem; (2) vote in the governance or control of

[9] An example might be a video game developer with a proprietary game platform. While any Tokens issued for use in the game might be freely transferable, the issuer would retain the ability to disable the platform and render the Tokens worthless.

[10] It should be assumed that an Offering of Tokens, for purposes of this exercise, could involve various areas where there is not necessarily incentive alignment between "equity holders" and "token holders" – token holders are a "stakeholder" to the extent there is an incorporated entity (performing more than an administrative function) but disclosures should not assume there is incentive alignment between all stakeholders. We should also make room for conceptual shifts in disclosure: (a) dependence on management concepts become dependence on community (members) where appropriate and discuss points of centralization; (b) the structure of the project will impact who we attribute liability to for incorrect disclosure; and (c) technology-based risks versus human dependencies.

[11] These definitions are drawn in part from the Proposed Safe Harbor. We acknowledge that the definitions we have provided here may benefit from refinement in response to comments by the staff and the public.

an Autonomous Cryptosystem or on parameters or features thereof[12]; or (3) capture, track, access, receive or otherwise benefit from the value of an Autonomous Cryptosystem (including any Tokens paid into such Autonomous Cryptosystem as usage fees); and (ii) except for implied rights in connection with clause '(i)', does not represent the contractual right to receive any payment or distribution from any person (in respect of any payment of principal or interest on a debt, distribution of profits, assets or dividends, or otherwise).

- **Autonomous Treasury** means an Autonomous Cryptosystem that exclusively controls either the generation of or issuance of un-generated or unissued Autonomous Tokens of a given type based on the results of governance voting of issued Autonomous Tokens of the same type.
- **Code** means a copy of certain software code such that: (a) the software code was designed primarily to be run and facilitate transactions on one or more Networks; (b) the copy is verifiably stored and has its results of execution recorded on the Open Ledger of a Network; and (c) the copy is executable by any open Client within the execution environment of the Network, provided that: (1) the software code is freely and readily available and licensed to the general public for use, copy, study and modification[13]; and (2) if the copy consists of bytecode, machine code or other non-human-readable code, then the copy was verifiably compiled from human-readable source code that is freely and readily available and licensed to the general public for use, copy, study, and modification.
- **Cryptosystem** means: (a) the combination of a particular Network and an Open Ledger maintained thereby; or (b) the combination of particular Code, a particular Open Ledger on which the Code is verifiably stored and a particular Network which maintains such Open Ledger and executes such Code.[14]
- **Development Team** means, as of a given time, any person, group of persons, or entity that is providing the essential managerial efforts for the development of a Network.
- **Executive Developer** means a member of the Development Team who directly or indirectly beneficially owns or has the right or power to receive or control 1% or more of the total maximum possible supply of the Offering Tokens.

[12] We envision that these governance votes will be binding on the relevant Cryptosystem. To the extent the cryptosystem permits only non-binding "signaling" votes, or which treats votes as directives to third parties to undertake some action, the Token would not constitute an Autonomous Token.

[13] The exact form of license may vary, but examples include GPL 3.0 and Apache 2.0

[14] Examples of Cryptosystems include "base layer" systems such as Ethereum and the various "dApps" or "smart contracts" which leverage the Ethereum base layer as a computing environment.

- **Extrinsically Affiliated**[15] means, with respect to any two persons and any Tokens, that: (a) due to arrangements or agreements outside of the Cryptosystem (such as ownership of one person's equity securities by another), one such person directly or indirectly controls, is controlled by or is under common control with, the other person in respect of their acquisition, holding, voting, using or disposing of the Tokens; or (b) such persons have agreed to act together for the purpose of acquiring, holding, voting, using or disposing of the Tokens; provided, however, that two persons independently using or agreeing to use the Tokens for their intended purposes within the Cryptosystem (such as by participating in a proof-of-stake consensus process that results in agreement among stakers or validators) shall not be considered Extrinsically Affiliated solely on that basis.
- **Insider** means a Person that (i) directly or indirectly is the beneficial owner of 10 percent or more of any class of any equity security of the Issuer, (ii) any Treasury Custodian, (iii) the Development Team, and (iv) each director, officer or manager of the Issuer or any Affiliate of the Issuer and (v) any Person meeting the definitions in (ii) through (iv) above in the 90-day period preceding the time of measurement.[16]
- **Issued Tokens**[17] means Tokens that have been generated and sent to (i) wallets or multisigs where the beneficial owners of such instruments having the power to control the disposition of such Tokens are non-Affiliates; or (ii) to Affiliates other than in the context of establishing a Treasury designated to custody or store Tokens.
- **Issuer**.[18] As defined in section 2(a)(4) of the Securities Act.
- **Large Holder** means a Person that directly or indirectly is the beneficial owner of ten percent (10%) or more of the Issued Tokens.
- **Network** means a peer-to-peer network that: (a) consists of computers running Open Clients which transmit and receive data among each other over the Internet, execute operations on such data and record such data and the results of such operations on an Open

[15] Extrinsic Affiliation is intended to capture voting collusion concepts, such as delegation, proxying, voting blocs, etc. It should serve to expand upon the definition of "Group" in securities laws beneficial reporting requirements.

[16] This is intended to capture a lookback at the time of Offering, any Token Shelf or reporting obligations, if implicated.

[17] This definition is intended to mirror the concepts of authorized versus issued stock, with the difference being that “unissued” means Tokens that are in a Treasury where Issuer retains control over how the Tokens are allocated versus everything else. Within specific disclosures, it will be helpful to further distinguish between Issued and fully-diluted Tokens (i.e., excluding lockups with no voting power and vesting/options/warrants). In the market, locked tokens held by venture investors are counted in circulating supply figures, even during the term of the lockup.

[18] More granularity may be needed to define who would be a co-issuer, active participant or other statutory seller in the context of the specific structures we see in the market.

Ledger; and permits any Internet-connected computer running the Open Client to obtain an accurate and complete copy of the Open Ledger and freely transmit messages to and read messages from all other Open Clients on such network, in each case, without any permission, authorization, identification or credentialing of such computer or the owner or operator of such computer.

- **Network Maturity** means, with respect to an Autonomous Network, when:
  - (a) fewer than 10% of Autonomous Tokens are directly or indirectly owned beneficially by the Development Team or any other person or group of affiliated persons, individually or in the aggregate;
  - (b) fewer than 10% of the means of determining consensus in accordance with the consensus rules on the Autonomous Network are directly or indirectly owned beneficially by the Development Team or any other person or group of affiliated persons, individually or in the aggregate;[19]
  - (c) there is substantial funding independent of the Development Team available for research, development and maintenance of the Autonomous Network protocol and software client(s), and such research, development and maintenance is not directly or indirectly controlled by the Development Team or any other person or group of affiliated persons; and
  - (d) the development covenants undertaken by the Development Team as disclosed in the Disclosure Statement have been performed in all material respects (except to the extent such performance has been waived or modified pursuant to the governance process disclosed in the Disclosure Statement).
- **Open Client** means: (a) human-readable software code implementing a peer-to-peer networking and data consensus software protocol that allows participants in the network to form consensus regarding the canonical data and to perform transactions involving Tokens on the Open Ledger; and (b) all machine code, bytecode, runtime code and other derivatives of the software referred to in the preceding clause '(a)', provided that the software described in the preceding clauses '(a)' and '(b)' of this paragraph is freely and readily available and licensed to the general public for use, copy, study and modification.
- **Open Ledger** means an electronic database that: (a) is created, stored and updated by a peer-to-peer network of Open Clients; and (b) can be independently verified through

[19] The "means of determining consensus" may refer to "hashrate", "stake", or other concepts depending on the exact design of the Cryptosystem.

cryptographic methods as having been created and updated in accordance with the data consensus protocol embedded in the Open Clients.

- **Person** means any "person" as such is defined in Section 3(a)(9) of the Exchange Act) or "group" (as such term is used in Rule 13d-5 under the Exchange Act)
- **Qualifying Distribution** means distributions of Tokens (1) that meet the requirements of the Safe Harbor, (2) Representational Tokens (3) Network Generated Tokens, (4) Tokens issued or used solely for development, testing or experimental purposes.[20]
- **Network Generated Tokens** means Tokens that may be issued pursuant to mining or staking, rewards or inflationary or dilutive controls within a Network; provided, that any such new Tokens dilute all Tokens of the same kind equally and shall be issued in accordance with the governance terms or consensus algorithm of a Network and not at the discretion of any Issuer or Insider, in each case acting alone or in concert with Affiliates.
- **Offering Tokens** means Tokens of the type and kind issued in the Reg X Offering.
- **Representational Tokens**[21] means any type of Token that: (i) without reduction or dilution of the value of or economic, governance or other powers and benefits of the Offering Tokens, is derived from or designed to represent or to be convertible with (A) the Offering Tokens or (B) the value of or economic, governance or other powers and benefits of such Offering Tokens (including pursuant to any 'liquid staking' or similar arrangements); (ii) cannot be minted, generated, credited, assigned or otherwise come into existence without staking, converting, depositing, locking, burning or otherwise removing from circulation a proportional amount of the type of Offering Tokens; and (iii) cannot remain in circulation except while the proportional amount of Offering Tokens referred to in the preceding clause '(ii)' remains out of circulation.
- **Related Party/Related Person** (i) any director or officer of the Issuer; (ii) any member of the Development Team; (iii) the beneficial owner of [ten percent (10%)] or more of the Issuer's outstanding voting equity securities, calculated on the basis of voting power; (iv) if the Issuer was incorporated or organized within the past three years, any promoter of the Issuer; or (v) any member of the family of any of the foregoing persons, which includes a child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or

[20] Though these would fall outside of securities laws, these would nevertheless be subject to disclosure, with such disclosure subject to update through ongoing reporting obligations.

[21] Examples of Representational Tokens include the "LP Tokens" used by automated market maker systems, "staked" governance tokens, etc.

sister-in-law, and shall include adoptive relationships. The term *spousal equivalent* means a cohabitant occupying a relationship generally equivalent to that of a spouse.

- **Token** means any electronic unit of account or representation of such units that (i) is created, stored, transferred and updated within and by means of a Cryptosystem; (ii) could reasonably be expected to have present or future material pecuniary value; and (iii) does not represent the contractual right to receive any payment or distribution from any person (in respect of any payment of principal or interest on a debt, distribution of profits, assets or dividends, or otherwise).[22]
- **Treasury** means a Cryptosystem that exclusively controls either the generation of or issuance of un-generated or unissued Tokens of a given type based on (i) the results of governance voting of issued Tokens of the same type or (ii) an arrangement set and/or controlled by the Development Team.
- **Treasury Custodian** means (i) any Affiliate(s) of the Issuer that directly, or indirectly through one or more intermediaries, custodies [10]%[23] or more of the Treasury (whether or not such Person controls the Treasury)[24] for the Offering Tokens, (ii) any Persons that are Related Persons who individually or collectively, directly, or indirectly through one or more intermediaries, control the Treasury for the Offering Tokens.
- **Trading Platform** means a multilateral system operated by any organization, association, or group of persons which brings together multiple third-party buying and multiple third-party selling interests and provides a mechanism for executing trades, in accordance with non-discretionary rules, in one or more Tokens. "Trading Platform" does not include (a) single-dealer platforms or over-the-counter (OTC) trading desks in which the dealer or OTC desk is a counterparty to the transactions; (b) aggregator or order routing services; or (c) other technology solutions that do not provide a mechanism for executing trades.

  In addition, unless the context otherwise requires, the following terms shall have the following meanings:

  - Software means (a) computer programs (including bytecode or source code) that comprise a series of instructions, rules, routines or statements, regardless of the

[22] Part (iii) of this definition is intended to prevent regulatory arbitrage by excluding categorically any "tokenized" debt, equity, or similar traditional securities.

[23] We have bracketed thresholds throughout the proposal where more analysis would be helpful to arrive at a number.

[24] This is meant to pick up foundations, whether or not they ultimately control the means to direct Treasury funds, and any related parties that have the ability to direct Treasury funds.

media in which recorded, that allow or cause a computer to perform a specific operation or series of operations; and (b) recorded information comprising source code listings, design details, algorithms, processes, flow charts, formulas and related material that would enable the computer program to be produced, created or compiled.

- Free software means any software that is freely licensed to the general public to run, copy, distribute, study, change and improve in accordance with the definition of "free software" promulgated by the Free Software Foundation.
- Source code means computer programs written in a high-level computer programming language primarily intended to be read and written by humans.
- Bytecode means computer programs compiled from source code into a low-level computer programming language primarily intended to be read and executed by an interpretive computer program within a virtual machine environment.

## III. Required Exemptions in Connection with Reg X Framework

As a preliminary matter, certain aspects of the existing securities laws are fundamentally incompatible with Reg X. We suggest the following non-exhaustive list of potential clarifications and exemptions from existing law to enable the Reg X regime.

- **Exchange Act Section 12(g) –** The application of 12(g) is not practicable for early-stage companies generally, which has led to relief such as the safe harbor under Reg CF. In the case of Tokens, more than impracticable, Section 12(g) is incompatible, particularly with the end goal of network decentralization. Networks are generally designed to be widely used and thus, Tokens are designed to be widely held. The Reg X framework is designed as an alternative to a registration for Tokens. The definition of Tokens is designed to be narrow such that Issuers will not be able to avail themselves of Reg X for electronic equity or debt offerings that should be conducted under existing frameworks.[25]
- **Blue Sky Laws –** For reasons similar to those stated above, as well as the inherent characteristics of transferability of Tokens, Blue Sky rules are even less apt for Tokens. Preemption of these rules would be necessary for Reg X to function as intended. Preemption under Reg X mirrors the preemption of Reg CF and Reg A+.

[25] We are leaving open the possibility that an Issuer seeking a listing of Tokens on a Trading Platform may need to undergo additional steps, including that the listing may trigger registration of its equity in addition to reporting obligations under 12(g).

- **Investment Company Act Registration –** Existing securities laws would need to provide a carveout that with respect to the Investment Company Act, such that the Issuer, and any Affiliates or Treasury Custodians who hold the (i) Offering Tokens and (ii) Tokens issued in Qualifying Distributions would not be subject to the registration requirements of the Investment Company Act.[26] Without this carveout, Issuers and Treasury Custodians would be required to register as Investment Companies despite having no meaningful connection to investment activities envisioned by the Investment Company Act.
- **Broker/Dealer** – The Commission should provide clarity that "mining" and "staking" transactions (which serve principally to bring Networks into consensus) do not implicate broker/dealer laws, and that the resulting fees or compensation from such transactions do not constitute compensation from users for effecting Token transfers. Applying these regulations to these activities would disincentivize projects from "opting in".
- **Facilitating Peer to Peer Transfers:**
    - **Requirements for Transfer Agents and Custodians** - Smart contracts enabling P2P exchange render transfer agents and custodians unnecessary. The public policy purposes of these regulations, while appropriate for traditional securities, is obviated by the technology. Accordingly, imposition of these requirements is arbitrary and counterproductive.
    - **Rule 144** – As noted above, Tokens would be freely tradable on a secondary market and P2P. Reg X does, however, mirror some of Rule 144's obligations for resale (like market disclosure) as well as restrictions attendant to control securities, without subjecting Tokens more broadly to Rule 144 restrictions, which would be unduly burdensome in the context of peer-to-peer transfers.
- **Regulation ATS** – While additional requirements would be imposed on Issuers who seek to sponsor a listing of the Offering Tokens on Trading Platforms, the Offering Tokens would be freely transferable except as otherwise provided by Reg X.

## IV. Detailed Walkthrough of Proposed Exemption

Below we describe the contours of the proposed Reg X exemption framework.

[26] An "Investment Company" includes issuer who "owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets") https://www.law.cornell.edu/uscode/text/15/80a-3

### 1. Scope of Exemption

As the Reg X framework is inspired by Reg A and Reg CF, not all issuers would be eligible to conduct offerings. Nonetheless, we believe that the scope of eligible issuers for Reg X should be expanded to include certain non-U.S. issuers, as discussed further below. And just as Reg A and Reg CF have limitations on the types and amounts of securities that may be sold by the issuer and selling securityholders, so too would Reg X. Reg X also addresses novel issues that result from blockchain technology and digital asset innovation.

#### a. Eligible Issuers and Securities

Regulation X is not available to the following types of Issuers:

- BDCs (companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies);
- companies registered or required to be registered under the Investment Company Act of 1940;[27]
- Issuers seeking to issue an asset that does not meet the definition of a Token;
- Issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights;
- Issuers (including affiliates that constitute co-issuers) that are in bad standing for having failed to comply with the reporting requirements under any other securities reporting regime during the two years immediately preceding the filing of the offering statement;
- Issuers that are or have been subject to an order by the Commission denying, suspending, or revoking the registration of a class of securities pursuant to Section 12(j) of the Exchange Act that was entered within five years before the filing of the offering statement;
- Issuers subject to "bad actor" disqualification under Rule 262;
- Non-U.S. issuers that are ineligible to use the Form F-1 (limited to foreign private issuers as defined in Rule 405 (§230.405));[28] and

[27] For purposes of this definition, we are relying on the carveout described in Section III above for clarification that the Issuer's Tokens will not constitute securities for purposes of the Investment Company Act.

[28] These categories were largely carried over from Reg CF/A but the SEC should consider allowing non-U.S. companies to use Reg X. These companies would be doing so to access U.S. capital markets and would subject themselves to U.S. securities laws, filing the same information with U.S. counterparts. Given the global nature of decentralized networks, we have observed that a significant amount of innovation occurs outside of the U.S. and that *bona fide* entrepreneurs have been incentivized to exclude the

- companies that are required to register their equity securities under 12(g) but have not completed such registration process, including as required herein for companies who have listed or are pursuing a listing of the Offering Tokens on a Trading Platform.

Similarly, Reg X imposes limits on the types of tokens eligible for sale under Reg X to specifically carve out equity interests in the Issuer and securities convertible into equity of the issuer such as warrants, SAFEs and convertible notes[29]. Reg X fundraising portals will act as gatekeepers to prevent Issuers from attempting to arbitrage securities laws to offer "tokenized" equivalents of traditional securities offerings under this exemption.

**b. Offering Limitations and Secondary Sales**

Unlike Reg A, Reg X would be streamlined rather having different offering tiers with differing requirements. We have chosen heightened disclosure requirements in line with Tier II of Reg A (with modifications and supplemental disclosures we believe are necessary, and subject to the higher tier of the Reg CF financial statement requirements) and, where applicable, disclosure on equity securities of Issuers with 12(g) registration requirements.

If an Issuer desires to issue additional Offering Tokens following an initial Reg X Offering, the Issuer would be able to use a "Token Shelf": an offering through an intermediary whereby the Issuer would be subject to the same eligibility requirements as Reg X, but would have truncated reporting obligations whereby the Issuer may file a statement consisting of (i) a facing page; (ii) a statement that incorporates by reference the contents of the earlier filing, identified by file number and a hyperlink; (iii) its ongoing reports (including all material updates to the information contained therein); (iv) a signature page; and (v) any additional Tokens being offered and price-related information.

Similar to Reg A+, sales by existing holders of Offering Tokens would be permitted as part of an Issuer's first Reg X Offering, as well as any Token Shelf in the following 12-month period. However, such co-sales would be limited to no more than 30% of the aggregate number of Tokens sold by the Issuer during

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U.S. participants due to the regulatory uncertainties surrounding digital assets under U.S. securities laws. We reiterate the benefits expressed by other commentators in the past in the context of the proposed rule for Reg A+:

> *"...including job creation, increasing the amount of disclosure available for investors in foreign companies, encouraging domestic exchange listings, expanding investment opportunities for U.S. investors, and general economic benefits. One commenter recommended making all foreign private issuers eligible if they maintained a principal place of business in the United States. Two commenters also recommended permitting companies relying on Exchange Act Rule 12g3-2(b) to make offerings under Regulation A."*

[29] We would expect that, in the interest of harmonization between existing securities law and securities law guidance relating to Tokens, there would be further definition developed around ineligible tokens that would amount to a narrowed version of the enumerated list in Section 3(b)(3) of the Securities Act. (*See* https://www.law.cornell.edu/uscode/text/15/77c).

that period.[30,31] These limits would apply only to priced offerings, as "airdrops" and similar distributions where no proceeds accrue to the Issuer do not implicate the same risks.[32]

### c. Investment Limitations in X Offerings

Borrowing from Reg A+ and Reg CF, we propose individual investment limitations, albeit with broader-based limitations. An investor who is not an "accredited investor" under Rule 501(a) of Regulation D would be limited to purchasing no more than: (a) 15% of the greater of annual income or net worth (for natural persons); or (b) 15% of the greater of annual revenue or net assets at fiscal year-end (for non-natural persons) in a 12-month period.[33] These limits would be enforced by fundraising portals, based on purchaser representations to the portals and supplemented by portal diligence. These investment limits would apply only to investments of ascertainable monetary value, thereby permitting methods of distribution that do not pose risks to investors, such as airdrops.

We also propose an individual limitation on the investment amount for all investors, inclusive of accredited investors. The amount limitation would not be based on net worth or income but would apply broadly to ensure a wide distribution of Tokens in the offering. Under Reg X, any Person investing (inclusive of their Affiliates), would only be allowed to purchase up to a maximum of [9.99]% of the total amount to be sold pursuant to the Reg X Offering. Investors exceeding this threshold, inclusive of existing holdings, would be subject to a beneficial ownership reporting regime akin to 13D and 13G.[34]

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[30] We are reluctant to facilitate Insider exit liquidity due to the risks it imposes on retail investors; however, we would prefer that these sales occur transparently and this resale limit is consistent with that provided in existing securities laws. Additionally, these resale limits would provide more certainty around underwriter liability for early purchasers. Selling tokenholders would also be limited in their participation by any pre-existing vesting or lockup requirements attached to their Tokens, which would need to be disclosed at the time of the offering.

[31] As a possible alternative, the co-sale regime could permit unlimited sales by existing tokenholders, provided that the sale price of the Tokens were no more than the price at which the holder originally obtained the Tokens. This would allow divestment without "dumping" on retail investors.

[32] An "airdrop" is a gratuitous distribution of tokens – the proverbial "helicopter money". Airdrops are typically used to accelerate the decentralization of a network by widely distributing tokens. Airdrops are also used to generate user interest in a platform, much like the credits offered by startups such as PayPal and Uber. Because the recipients of such tokens do not invest or otherwise risk any capital, there are fewer risks attending Insider exit liquidity concurrent with an airdrop.

[33] This threshold is open for further analysis with the underlying thought process that the disclosures are more strenuous than CF and closer to Reg A, which does not have a cap on retail. Further, there are ongoing reporting requirements to solve information asymmetries. Accordingly, the cap should be higher than in a Reg CF offering and it is an open point how to set this threshold. An alternative might be to impose a per-offering cap, although we believe that this structure disincentivizes careful review of offering materials.

[34] This threshold is intended to match the insider trading regime, but based on circulating supply. We imaging building out a 13D/13G reporting regime from and after the Offering that could capture acquisitions of more than 5% of the Issued Tokens. A lower threshold may be appropriate given the intent that Tokens have a wider distribution than traditional securities. We support the SEC proposed rule to reduce reporting times in the context of beneficial ownership and would also support establishing mechanisms for close-in-time reporting of significant acquisitions and divestitures by reporting beneficial owners.

**d. Restrictions on Resale**

A condition of completing a Reg X Offering would be to ensure that, other than the 30% co-sale allocation for Token holders, for the 12-month period following the Offering (the "**Lockup Period**"), there are sufficient lockups in place on (i) issuances and prior allocations that vest during the Lockup Period and (ii) any future issuances of the Offering Tokens. This non-waivable lockup would apply to both Insiders and Large Holders, preventing them from reselling their Offering Tokens for the duration of the Lockup Period.[35] This requirement is intended to prevent (i) Large Holders and Insiders or (ii) subsequent offerings conducted using another exemption (such as Reg D) from negatively influencing the price of the Tokens through large sales of Tokens in what is colloquially referred to as a "dump."[36]

**e. Integration**

We propose that, similar to the safe harbors under Rule 152(b), a new fifth safe harbor[37] for integration be created for Reg X offerings: "Offers and sales made in compliance with Reg X will not be integrated with other securities offerings where the asset being offered in such other securities offering does not include a Token." We believe this is an appropriate safe harbor because the asset being offered under our proposal is intended to be tailored specifically to Tokens that meet the definition and not include electronic representations of traditional securities instruments. At the same time, we do not believe that an Issuer should pursue a simultaneous Reg D offering or private placement of Offering Tokens to avoid the limitations set forth herein. Accordingly, the restrictions imposed by the lockups contemplated in Section (d) above are intended to offer protection from these types of issuances during the Lockup Period.

**f. Treatment under Section 12(g)**

We suggest that the SEC provide clarification that 12(g) is not applicable as it relates to holders of Tokens. However, there are a variety of scenarios where it makes sense from a public policy perspective to layer on the existing Exchange Act reporting regime with respect to an Issuer's equity if, notwithstanding whether the thresholds for outstanding equity securities are met, (i) the Issuer meets the asset test, including as a result of the Offering **and** (ii) (A) centralization thresholds with respect to the Tokens are met with

[35] This mirrors existing best practices in the market, which include multiple year lockups and linear unlocks for venture capital /early investors and insiders.

[36] This is not a problem endemic to tokens. The "dump on retail" is a significant issue in traditional markets.

[37] https://www.sec.gov/rules/final/2020/33-10884.pdf

respect to the Issuer, Insiders and the Development Team or (B) the Issuer is pursuing a listing for the Tokens on a Trading Platform.[38]

### 2. Offering Statement

All issuers that conduct offerings pursuant to Regulation X are required to electronically file an offering statement on Form X on EDGAR. Form X consists of three parts:

- Part I: an eXtensible Markup Language (XML) based fillable form;
- Part II: a text file attachment containing the body of the disclosure document and financial statements; and
- Part III: text file attachments, containing the signatures, exhibits index, and the exhibits to the offering statement.

#### a. Part I

Part I of Form X provides certain basic information about the issuer and its proposed offering. This information helps to confirm the availability of the exemption. The notification in Part I of Form X requires disclosure in response to the following items:

- **Item 1. (Issuer Information)** requires information about the Issuer's identity, its Affiliates, including any Treasury Custodian entities[39], industry, number of employees, financial statements and capital structure (including disclosures, as appropriate for a given model, including allocation of Token supply and details around the Token economic model, supply caps, and issuance schedule; and current and intended functionality), including information with respect to Insiders, as well as contact information.
- **Item 2. (Issuer Eligibility)** requires the issuer to certify that it meets various issuer eligibility criteria and that the Token meets the definition.
- **Item 3. (Application of Rule 262 ("bad actor" disqualification and disclosure))** requires the issuer to certify that no disqualifying events have occurred and to indicate whether related disclosure will be included in the offering circular.
- **Item 4. (Summary Information Regarding the Offering and other Current or Proposed Offerings)** includes indicator boxes or buttons and text boxes eliciting information about the offering.

[38] For more centralized Issuers, there should be interactions between these reporting regimes, incorporation by reference and notice requirements (current event reporting).

[39] We envision that Treasury Custodians should be required to provide disclosures that will form exhibits, and attest to the nature of their activities, including information about their custody arrangements, the size of any token grants and transactions with the Issuer and its Affiliates, as well as related party transactions.

- Summary Information to include token disclosure and equity/control person disclosure
- Information regarding Qualifying Distributions

- **Item 5. (Jurisdictions in Which Securities are to be Offered)** requires information about the jurisdiction(s) in which the securities will be offered.
- **Item 6. (Offering Tokens, Unregistered Securities Issued or Sold Within One Year)** requires disclosure about material unregistered issuances or sales of securities to date.

**b. Part II**

Part II of Form X contains the primary disclosure document that an issuer will prepare in connection with a Regulation X offering, called an "offering circular." Issuers are required to provide financial disclosure in Part II that follows the requirements of Reg CF for audited financial statements.[40]

(i) **Offering Circular Format**

The Offering Circular format is a simplified and scaled version of the narrative disclosure requirements otherwise required to be provided by issuers in registered offerings on Form S-1 or Form S-11, with the modifications to disclosure of the type set forth herein, and will include discussion about the material elements of the decentralized model, including as applicable the blockchain, the Token (and its intended allocation and supply), the product, path to decentralization and specific risks related to each. In addition to the availability of certain scaled disclosure items, the Offering Circular format is meant to simplify the process by which an issuer prepares its narrative disclosure by limiting the need for issuers to look outside the form for disclosure guidance. We expect these disclosures to track those contained in the Reg X Safe Harbor without reference to the "autonomous" definitions (collectively, the "**Reg X Crypto Disclosures**"):

(i) **Source Code**. The complete source code for the relevant Open Client and Code, together with the complete text of the free software licenses pursuant to which such source code is licensed to the public (each of which may be incorporated by reference from a suitable public software repository).

(ii) **Transaction History**. A narrative description of the steps necessary to independently access, search, and verify the transaction history of the relevant Cryptosystem.[41]

[40] We believe that an AICPA audit standard is appropriate as it is impracticable to impose PCAOB audits on Issuers until FASB arrives at definitive guidance for Tokens. There may also be extreme frictions experienced by an Issuer seeking dual 12(g) registration in attempting to engage an independent auditor that is subject to Section 11 liability without accommodation. See https://www.armaninollp.com/-/media/pdf/white-papers/white-paper-sec-form-10-filing-timeline.pdf; and https://us.aicpa.org/content/dam/aicpa/interestareas/informationtechnology/downloadabledocuments/accounting-for-and-auditing-of-digital-assets.pdf

[41] Generally, this will entail detailing the requirements necessary to operate an Open Client. We expect this description to expand to more user-friendly options, such as third-party block explorers, over time.

(iii) **Token Economics**. A narrative description of the purposes and operation of the Token and the corresponding Cryptosystem. At a minimum, such disclosures must include the following:

(a) Information explaining the launch and supply process for the Token, including the number of Tokens that were issued in the initial allocation, the total number of Tokens to be created, the release schedule for the Tokens, the allocation of the Tokens to certain uses (e.g. grants, marketing, partnerships, future employees of the Issuer) and the total number of Tokens outstanding;

(b) Information detailing the method of generating, mining (and, if applicable, staking, locking or burning) Tokens and, if the corresponding Cryptosystem consists of the combination of a particular Network and an Open Ledger maintained thereby:

1) the process for validating transactions within, and the consensus mechanism for, such Cryptosystem;
2) sufficient information for a third party to create a tool for searching, viewing and verifying the transaction history of the Token (e.g., the blockchain or distributed ledger); and
3) A hyperlink to a block explorer for the relevant Cryptosystem;[42]

(c) A detailed explanation of governance mechanisms for implementing changes to the Cryptosystem, including identification of any persons that can act unilaterally or in concert to change the canonical source code, parameters, or system state.

(iv) **Prior Token Sales**. The date of sale, number of Tokens sold prior to filing the Form X-Z including through Reg X, any limitations or restrictions on the transferability of Tokens sold, and the type and amount of consideration received. Issuers should provide hyperlinks to the relevant filings with the Commission for any such offerings (i.e. Form X or Form D filings).

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

(a) The names and relevant experience, qualifications, attributes, and skills of each Executive Developer;

(b) The number or percentage of the total maximum possible supply of Tokens that each Executive Developer beneficially owns or has the right to receive or control and a description of any limitations or restrictions on the transferability of Tokens that any member of the Development Team beneficially owns or has the right to receive or control;

[42] Paradoxically, sole/exclusive maintenance of a block explorer by the Issuer is an impediment to decentralization because it suggests that the Issuer's copy of the Open Ledger is the canonical one and therefore puts the Issuer in a privileged position relative to other entities. The path to decentralization should therefore permit third parties to duplicate and host block explorer software released by the Issuer.

(c) If the Development Team, any member of the Development Team or, to the extent known to Development Team, any of their respective Related Persons has a right to obtain Tokens in the future in a manner that is distinct from how any third party could obtain Tokens, identify such person and describe how such Tokens may be obtained; and

(d) Copies of all material agreements between or among any one or more of the Development Team, any of its members or, to the extent known to the Development Team, any of their respective related persons, in each case, which relate in any material respect to the Cryptosystem or Tokens.

(vi) **Sales of Tokens by the Development Team**. Disclosure should be made to supplement any existing disclosure regarding sales of Tokens by the Development Team from and after the last periodic report or otherwise not disclosed. From and after the filing of the Form X-Z, each time an Executive Developer sells five percent of his or her Tokens as disclosed pursuant to paragraph '(v)(b)' of this section over any period of time, state, within 4 business days after the consummation of such sale, the date(s) of the sale, the number of Tokens sold, and the identity of the seller.

(vii) **Related Person Transactions**. A description of any actual or proposed material transaction[43] relating in any material respect to the Cryptosystem or Tokens in which the Development Team or any member thereof is a participant and in which, to the extent known by the Development Team, any of their respective Related Persons had or will have a direct or indirect material interest. The description should identify the nature of the transaction, the Related Person, the basis on which the person is a Related Person, and the approximate value of the amount involved in the transaction.

### c. Part F/S (Financial Statements)

Part II of Form X-A requires issuers to provide financial statements that include balance sheets and related financial statements for the two previous fiscal year ends (or for such a shorter time that they have been in existence). Like those Reg A+ Tier 2, Issuers in Reg X are required to include financial statements in their offering circulars that are audited in accordance with the standards applicable to Reg CF offerings of the highest tier. Part F/S requires issuers to include financial statements in Form 1-X that are dated not more than nine months before the date of non-public submission, filing, or qualification, with the most recent annual or interim balance sheet not older than nine months. If interim financial statements are required, they must cover a period of at least six months.

[43] We propose to use the Item 404 $120,000 standard for related party transactions.

#### d. Part III

Part III of Form X-A requires issuers to file certain documents as exhibits to the offering statement. Issuers are required to file the following exhibits with the offering statement: charter documents; instrument(s) defining the rights of equity securityholders and description of rights of Token Holders (including as they relate to equity and other securityholders and any governance rights within the Cryptosystem); any investment agreements (including side letters); voting trust agreements; material contracts; plan of acquisition, reorganization, arrangement, liquidation, or succession; escrow agreements; consents; "testing the waters" materials; appointment of agent for service of process; materials related to non-public submissions; and any additional exhibits the issuer may wish to file. Specifically related to Tokens, Part III would include exhibits for grant agreements pursuant to which the Issuer has transferred some or all its control over the Treasury (including "multisig agreements"), code audits and documentation related to any private sales and incentive grants, agreements with affiliates and related person transactions.

### 3. No Need for Qualification

Issuers are permitted to begin selling Tokens pursuant to Regulation X through the intermediary fundraising portal once the offering statement has been filed with the Commission.

### 4. Solicitation of Interest Materials

We expect that Issuers will be permitted to "test the waters" with, or solicit interest in a potential Reg X offering from, the general public either before or after the filing of the offering circular, provided that all solicitation materials include the legends required by the final rules and, after publicly filing the offering statement, are preceded or accompanied by a preliminary offering circular or contain a notice informing potential investors where and how the most current preliminary offering circular can be obtained. Issuers would be permitted to discuss the technology and Tokens, *provided* that such discussions are (i) limited to factual statements; (ii) posted on publicly-available websites or platforms identified on Form X-Z, and (iii) not intended to induce trading activity.[44]

[44] We envision a liberalized form of Reg CF's provisions permitting public communications. The "tombstone" style requirements of Reg CF, suitable for traditional securities, would unduly restrict a Token Issuer from providing updates regarding its product offerings. In particular, Reg CF's limitations on certain forms of communication makes it more difficult for Issuers to provide certain material information to investors, and the "one-stop shop" approach to disclosures may inadvertently act as a centralizing force. We expect that, as a Cryptosystem approaches Network Maturity, communications regarding the Cryptosystem or Tokens will expand beyond websites and platforms controlled by the Issuer, and the Issuer should not be precluded from participating in such communications so long as their activities are properly disclosed and are not designed to induce trading activity. We do not offer a rigorous definition here for "intended to induce trading activity", but the spirit of this language is to restrict the Issuer from "pumping" the Token. We believe that these standards need to be further developed with an eye toward flexibility to allow for the evolution of new models.

### 5. Ongoing Reporting

Issuers in Reg X offerings are required to provide information about sales in such offerings and to update certain issuer information by electronically filing a Form X-T offering termination report with the Commission on EDGAR not later than 30 calendar days after termination or completion of an offering. Issuers are required to electronically file annual and semiannual reports, as well as current reports and, in certain circumstances, an exit report on Form X-Z, with the Commission on EDGAR. These would include updates on the path to/status of decentralization and Network Maturity, such as number of: nodes/miners, token wallets[45], custody providers, wallet providers, dapps (if applicable), liquidity ventures/trading platforms, as well as the level of token ownership of insiders and involvement of the issuer.[46]

#### a. Reg X Offering Termination Report

Issuers in Reg X offerings are required to electronically file with the Commission on EDGAR certain summary information on terminated or completed Reg X offerings in an exit report on Form X-T not later than 30 calendar days after termination or completion of an offering.

#### b. Annual Report on Form X-K

Issuers are required to electronically file annual reports with the Commission on EDGAR on Form X-K within 120 calendar days of the issuer's fiscal year end. Form X-K requires issuers to update certain information previously filed with the Commission pursuant to Part I of Form X, as well as to provide disclosure relating to the issuer's business operations for the preceding three fiscal years (or, if in existence for less than three years, since inception), related party transactions, large private token sales (including by Affiliates and Treasury Custodians), beneficial ownership of the issuer's securities (Equity and Tokens), executive officers and directors (or persons performing management roles or otherwise control the Treasury), including certain compensation information, management's discussion and analysis (MD&A) of the Issuer's liquidity, capital resources, and results of operations, and two years of audited financial statements (or if shorter than two years, since inception), changes to whitepaper and Cryptosystem,[47] large transactions in the Token pursuant to which the Issuer, Development Team, Affiliates or Related Person were a party, grants by any Treasury Custodian and formation of new affiliates such as an investment arm.

[45] We propose a public float concept here that distinguishes which tokens are in the hands of non-affiliated holders (as opposed to Insiders and Large Holders).

[46] These are non-exhaustive types of disclosures that may be relevant. In practice, any measure of "decentralization" can be gamed and so thoughtful discussion of the nature of any "points of centralization" is preferable to superficial numbers.

[47] The frictions experienced by Props tokens are a point of reference to include elements of flexibility to allow product changes and flexibility without reporting obligations as an insurmountable burden. See https://blog.propsproject.com/a-letter-from-our-ceo-1332f6cabab1.

### c. Semiannual Report on Form X-SA

Issuers would be required to electronically file semiannual reports with the Commission on EDGAR on Form X-SA within 90 calendar days after the end of the first six months of the issuer's fiscal year. Form X-SA requires issuers to provide disclosure primarily relating to any significant changes to the information in the annual report, including the issuer's plans with respect to the Offering Tokens, the Network, the Cryptosystem, any Qualifying Distributions or business model, changes in concentration in the secondary market, interim financial statements and Development Team's D&A.

### d. Current Report on Form X-U

We believe that the ability to review on-chain data represents a paradigm shift offering unprecedented, real-time transparency. Therefore, certain kinds of disclosures may not be appropriate to the Reg X regime. However, with respect to "off-chain" data, Issuers in Reg X offerings will be required to electronically file current reports with the Commission on EDGAR on Form X-U within four business days of the occurrence of one (or more) of the following events:

- Fundamental off-chain changes;[48]
- Planned disabling of Tokens or Issuer-controlled platforms on which Tokens are used;
- Bankruptcy or receivership of Issuer;
- Material modification to the rights of holders of Tokens and/or holders of the Issuer's equity securities;
- Changes in the issuer's certifying accountant;
- Changes in code auditor, non-reliance on previous code audit and known bugs/vulnerabilities resulting in change to code auditor;[49]
- Non-reliance on previous financial statements or completed interim review;
- Changes in control of the issuer or significant purchases of tokens on the secondary market by insiders or affiliates;
- Departure of Issuer's principal executive officer, principal financial officer, or principal accounting officer or, if inapplicable, key members of the Initial Development Team; and

[48] There are certain reporting obligations that impact digital assets more than traditional securities. Blockstack serves as an illustrative example: Blockstack's tokens, as securities issued under a Reg A+ exemption, were subject to a requirement that "on-chain" changes on the network triggered reporting obligations.

[49] Although we regard code vulnerabilities as material information which should be disclosed, the dynamics of disclosing a hack or vulnerability differ with respect to blockchains and we defer to the accepted practice of "ethical disclosure" of such vulnerabilities, according to which a vulnerability is disclosed only after the developer has implemented a patch mitigating the vulnerability to minimize the harm to market participants. We imagine that the failure to mitigate (by inaction) on discovery would independently give rise to liability. Additional guardrails can be developed, but we would not want Issuers to be put in an impossible situation given the short lead time for current reporting.

- Unregistered sales of 10% or more of outstanding equity securities or 5% of the Issued Offering Tokens by the Issuer or its Affiliates.

The Form X-U would include an obligation to provide and maintain the same disclosures required by the Safe Harbor on a freely accessible public website that is listed in the Form X-Z and update the disclosure within four business days of a material change of such information; provided, however, that any required information will be deemed automatically amended by any public updates made to a code repository which was identified by and deemed to be automatically incorporated by reference into the existing disclosure.[50]

### e. Exit Report for Ongoing Reporting on Sufficient Decentralization (Form X-Z)

**Eligibility**.[51] Issuers that have filed all ongoing reports required by Reg X for the shorter of (1) the period since the issuer became subject to such reporting obligation or (2) its most recent three fiscal years and the portion of the current year preceding the date of filing Form X-Z, may immediately suspend their ongoing reporting obligations under Reg X at any time after completing reporting for the fiscal year in which the offering statement was filed and the Issuer meets requirements of the Safe Harbor:

(i) Network Maturity has been achieved, the Offering Tokens constitute Autonomous Tokens and any further issuances constitute Qualified Distributions; and

(ii) The Offering Tokens beneficially owned or controlled by the Issuer, the Development Team, its members and, to the extent known by Insiders, any of their respective Related Persons (and all rights, benefits and powers with respect thereto) have not been directly or indirectly sold or transferred (except without additional consideration from the Development team or its members to their respective Related Persons) for a period of at least 12 months from the date of the last Reg X Offering or Token Shelf, as applicable, of the Autonomous Tokens or, if less than 12 months have elapsed, are subject to programmatic lockups.[52]

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[50] We acknowledge that relatively few investors will have the ability to review or interpret code changes. Therefore, we envision that, while such code changes would be automatically incorporated by reference, Issuers would still be required to describe changes to the code via a changelog. Additionally, we envision that the repository would provide version control enabling users to compare any code before and after the changes.

[51] The concept of exit reporting exists in the traditional securities realm, although we liken this reporting to a gated version of reaching Network Maturity, in this context with regulatory buy-in and notice. This is closest to meeting the conditions of a no-action letter where there is a risk for the Issuer if they are not in compliance and do not engage in SEC dialogue if there are uncertainties. We see this also as an evolution of what Stacks attempted in December 2020 (see https://blog.blockstack.org/stacks-cryptocurrency-expected-to-reach-non-security-status-in-the-united-states/).

[52] This requirement essentially states that Insiders' liquidity events must be no earlier than one year from the closing of the last Reg X Offering. If less than one year has elapsed before the Issuer wishes to file an exit report, this lockup would be enforced by the Autonomous Cryptosystem itself.

In such circumstances, an Issuer's obligation to continue to file ongoing reports under Reg X would be suspended immediately upon the electronic filing of a notice with the Commission on Form X-Z. However, the secondary market reporting obligation would continue for Large Holders.[53]

**Filing of Exit Report**. The Exit Report must contain the following information:

(i) The name of each Executive Developer;

(ii) Attestation by an Executive Developer that the conditions of the Safe Harbor are satisfied;

(iii) An email address at which the Development Team can be contacted; and

(iv) The Reg X Crypto Disclosures, accurate as of the time of filing of the Form X-Z unless another recent practicable date is otherwise specified.[54]

#### f. Exchange Act Reporting Companies

We propose that being an Exchange Act reporting company should not disqualify an Issuer from conducting a Reg X offering. However, we believe there are circumstances where an Issuer seeking to take advantage of Reg X should be required to register under 12(g) because the holders of Tokens would benefit from a dual-reporting regime as it relates to such Issuers.

### 6. Bad Actor Disqualification

Reg X Offerings would be subject to "bad actor" disqualification provisions, such as those contained in Rule 262 of Regulation A that serve to disqualify securities offerings from reliance on Regulation A if the issuer or other relevant persons (such as underwriters, placement agents, and the directors, officers and significant shareholders of the issuer) (collectively, "covered persons") have experienced a disqualifying event, such as being convicted of, or subject to court or administrative sanctions for, securities fraud or other violations of specified laws. We recognize that the SEC harmonized the lookback period for Reg D, Reg A+ and Reg CF (both the time of filing of the offering document and the time of sale) and would propose that the same would apply to Reg X Offerings, provided that Large Holders of the Offering Tokens who are also Insiders would be additional "covered persons" subject to the bad actor disqualification provisions.

[53] We expect that SROs and other tools can and will be used to monitor secondary market compliance.

[54] At the time of the Exit Report, the Issuer would be in a position to cease operations entirely without affecting the operations of the Cryptosystem or functionality of the Token. Therefore, we believe any form of mandatory continued disclosure regime for the Issuer (such as hosting a repository of the source code) would not be appropriate. Under our proposal the SEC would serve as the final resting place for documentation provided by the Issuer up to the date of the Exit Report.

### a. Covered Persons

As with other securities offerings, Issuers would be required to conduct a factual inquiry to determine whether any covered person has had a disqualifying event, and the existence of such an event will generally disqualify the offering from reliance on Reg X. "Covered persons" include:

- the Issuer, including its predecessors and affiliated issuers;
- directors, general partners, and managing members of the issuer;
- executive officers of the issuer, including Executive Developers and other officers of the issuers that participate in the offering;
- 20 percent beneficial owners of the Issuer, calculated on the basis of voting power;
- 20 percent beneficial owners of Tokens who are also Insiders;
- promoters connected with the issuer in any capacity; and
- persons compensated for soliciting investors, including their directors, executive officers or other officers participating in the offerings, general partners and managing members

### b. Disqualifying Events

We expect that disqualifying events would be the same as those under Reg A and Reg CF.

### c. Reasonable Care Exception

Similar to Reg A, an exception from disqualification should apply when the Issuer is able to demonstrate that it did not know and, in the exercise of reasonable care, could not have known that a covered person with a disqualifying event participated in the Reg X Offering.

The steps an Issuer should take to exercise reasonable care will vary according to particular facts and circumstances. A note to the rule states that an issuer will not be able to establish that it has exercised reasonable care unless it has made, in light of the circumstances, factual inquiry into whether any disqualification exists.

### d. Other Exceptions

We expect these to mirror exceptions for Reg A.

### e. Waivers

We expect there to be a similar ability to seek a waiver from disqualification by the Commission upon a showing of good cause that it is not necessary under the circumstances that the exemption be denied. Staff has identified a number of circumstances that could, depending upon the specific facts, be relevant to the evaluation of a waiver request for good cause shown: http://www.sec.gov/divisions/corpfin/guidance/disqualification-waivers.shtml.

### 7. Relationship with State Securities Laws

In parallel with Reg CF, Issuers in Reg X Offerings should work through intermediaries and make filings with the Commission before sales can be made pursuant to Reg X, but are not required to register or qualify their offerings with state securities regulators. Reg X Issuers, would however, remain subject to state law enforcement and anti-fraud authority.

### 8. Other Resources

Rules, Regulations, and Forms:

[1] Regulation A [17 CFR Part 230]
[2] Jumpstart Our Business Startups Act [Section 401]
[3] Regulation CF [17 CFR Part 227]
[4] Securities Act of 1933 [Section 2(a)(4)]
[5] Form 1-A [Regulation A Offering Statement]
[6] Form C [Regulation CF Offering Statement]
[7] Securities Act Rule 144 [17 CFR § 230.144]
[8] Securities Act of 1933 [Section 3(b)(3)]
[9] Regulation D [Rule 501(a)]
[10] Securities Act of 1934 [Section 12(g)]

List for Further Reading:
[1] Token Safe Harbor Proposal 2.0 [Commissioner Hester Pierce]
[2] What Should Be Disclosed in an Initial Coin Offering [Chris Brummer, Trevor Kiviat, Jai R. Massari]
[3] Defining Decentralization For Law [Gabriel Shapiro]
[4] Digital Asset Transactions: When Howey Met Gary (Plastic) [William Hinman]
[5] Running on Empty: A Proposal to Fill the Gap between Regulation and Decentralization [Commissioner Hester Pierce]
[6] Are Tokens Debt or Equity? Why it Matters [Gabriel Shapiro]

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