Token Safe Harbor Proposal 3.0
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This proposal seeks to exempt qualifying transactions in decentralized autonomous tokens or utility tokens from the registration requirements and certain other formalities of the securities laws. The proposal takes Hester Peirce's Safe Harbor Proposal 2.0 as its starting point; as with that proposal, the focus of this proposal is to solve the 'Catch-22' problem for tokens–that their utilities or value-drivers may take some time to become fully functional or decentralized, and during that time the *Howey* test may be satisfied as to related "contracts, transactions, or schemes" involving the token. To foster the market for cryptocurrencies and blockchain technologies, developers should be given a time-limited reprieve from the registration requirements of the securities laws in order to complete the research, development, testing, distribution and bootstrapping necessary to establish a decentralized autonomous system or app-based token economy.

The main themes of the changes embedded in Proposal 3.0 from the text of Proposal 2.0 are as follows:

- Clearly delineating the "utility" path for non-securities status from the "decentralization" path for non-securities status. Both paths were present in Proposal 2.0, but the distinctions between them were less clear.
- Clarifying that risk-capital-raising sales of Tokens to investors remain investment contracts and thus must be either registered or exempt from registration, but, if they are thus registered or exempt, do not cause loss of the overarching Rule 195 exemption for the token itself/other transactions in the token.
- Clarifying that certain other transactions in tokens are not investment contracts, with greater specificity than under the Proposal 2.0. For example, token grants to the developers of the applicable Blockchain System.
- Revising provisions relating to "networks" and the decentralization thereof to allow for decentralization tests to apply to smart contract systems and L2s, L3s, etc. rather than just pure blockchain "networks".
- Revising provisions relating to functionality to clarify that for tokens taking this path, more centralization/closedness is permitted for tokens primarily having a utility function within Qualifying Consumer Applications.

- Removing or mitigating certain potential loopholes that could facilitate quasi-equity-tokens under Proposal 2.0–tokens that just provide non-dilutive financing to conventional businesses as a form of 'shadow equity' should not get this exemption.

The following parts of this document are organized as follows:

- a redline of Proposal 3.0 against Hester Peirce's original Proposal 2.0, together with commentary in the corresponding footnotes explaining the reasons for each revision;
- a set of hypotheticals applying Proposal 3.0 to common fact patterns; and
- a clean copy of Proposal 3.0 (no redline).

The proposal is not a *complete* solution to all securities law issues with the cryptocurrency market, but represents a strong start to give most new teams/projects (and the existing financing and go-to-market strategies they already commonly use) clarity. One important complement for future work/proposals is creating a token-specific modification of the Reg CF and/or Reg A+ rules to allow for exempt public token *sales* for risk-capital-raising purposes (or proposing a new exemption for this purpose). Another important complement would be to solve various issues (such as Exchange Act issues and Investment Company issues) related to DeFi, though we have at least teased some solutions on those in this proposal as well.

PROPOSAL 3, REDLINED VS PROPOSAL 2

Proposed Securities Act Rule 195. Time-limited exemption for Certain[1] Blockchain Tokens.

(a) Exemption. Except as expressly provided in paragraph (d) of this section, the Securities Act of 1933 does not apply to any Qualifying Transaction[2] ~~offer, sale, or transaction~~ involving a Token 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~~Token Maturity[3] within three years of the date of the first sale of Tokens and makes continuous good faith commercially reasonable efforts to achieve such ~~Network Maturity~~Token Maturity within such three-year period[4];

(2) Disclosures required under paragraph (b) of this section are ~~must be~~ made available by the initial development team[5] on a freely accessible public website.

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[1] Due to the definition of "Qualifying Transactions" and certain other features of the proposal, not all types of blockchain tokens will qualify for the exemption, even if they are not 'intrinsic securities'. For example, a Token that is regularly 'bought and burned' as a fixed percentage of a centralized business' profits, would not qualify for the exemption, as this is essentially a pseudo-equity security based on the circumstances, even though it is not 'intrinsically' so (since it does not have specific rights).

[2] The exemption is limited to "Qualifying Transactions" because risk-capital-raising transactions are generally understood to constitute "contracts" or "transactions" that constitute investment contracts under *Howey* and thus should only qualify if they are otherwise exempt. Additionally, certain non-risk-capital-raising transactions may nevertheless be part of a "scheme" that constitutes an investment contract under *Howey. (See* SEC v. Telegram). The definition of "Qualifying Transaction" seeks to capture these nuances.

[3] In the original Safe Harbor 2.0 Proposal, the term "Network Maturity" uneasily combined aspects of a decentralized autonomous system and a 'utility token' intended for consumptive purposes. To make the handling of this issue more clear, we use the term "Token Maturity" instead—a Token can be mature if it relates to a decentralized autonomous system, but can also be mature if it is a 'utility' token within a consumer application, even if that application is centralized.

[4] The added language is intended to require more than just an initial statement of an intention to decentralize or create utility. Rather, there must be *bona fide* efforts throughout the safe harbor period to actually fulfill the intention.

[5] Generally, it seems best if there is a single reporting entity providing a consolidated report. Adding 'by the initial development team' here and elsewhere clarifies this. Of course, one could in theory take a more "MiCa-like" approach in which any party could provide disclosure for any token; however, this becomes complicated and may create risks of not having a clear party to hold responsible for problems. We also believe that basically every token project does initially have a clear initial development team and thus do not see significant risk with this.

(3) The Token is~~must be~~ designed by the initial development team ~~offered, and sold~~[6] for the purpose of facilitating access to, participation on, or the development of the ~~network~~Autonomous System or Qualifying Consumer Application[7].

(4) It is reasonably expected that, when ~~Network Maturity~~Token Maturity is achieved, the value of the Token will primarily be based on the Token's utility, consumptive purpose, general market forces, the efforts of a widely dispersed group of non-extrinsically-affiliated persons, or the adoption of the Blockchain System or Qualifying Consumer Application to which it is related, or any combination of the foregoing factors,[8] and not on the profits and losses or equity value of any single extrinsic enterprise related thereto[9].

(5) It is reasonably expected that, prior to ~~Network Maturity~~Token Maturity being achieved, any managerial efforts of the initial development team will primarily be intended in good faith to achieve Token Maturity during the three-year safe harbor period (e.g., by completing functionality of the Autonomous System or Qualifying Consumer Application or encouraging sufficient adoption of an Autonomous System allow the system to run on a decentralized basis), rather than on conducting general business activities the profits and losses of which would reasonably be expected to correlate with the profits and losses from purchases and sales of the Token[10].

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[6] The "offered and sold" language in the prior version was unclear in a few ways. On its face it potentially applied to *any offeror* or seller of the token, but presumably a third party who sells a token in some other way should not cause a loss of the exemption for the initial development team. The prior language was unclear on whether the token had to be *exclusively* offered and sold for utility purposes, or if just sometimes being sold for such purpose was enough. In contrast, the new language is cabined to the intentions of the initial development team; this creates more certainty, which in turn makes the exemption more reliable, and thus more valuable. Furthermore, the new language relates to the design of the token and thus its intrinsic features, but still allows the token to be offered and sold for other purposes (such as capital-raising) in early stages. Importantly, those other transactions will only be exempt under Rule 195 if they are already exempt under Regulation D or another conventional exemption.

[7] Keeping with the spirit of the Safe Harbor Proposal 2.0 but seeking greater clarity of implementation, we have broken the safe harbor paths into two. A Token can become "mature" if its value is primarily linked to an Autonomous System, but can also become "mature" if it is primarily a 'utility' token within a Qualifying Consumer Application. The former requires "decentralization", the latter does not.

[8] This clause is intended to capture the idea that, for a token to qualify for the Rule 195 exemption, transactions in the token generally must not constitute part of a "scheme" that is a *Howey* investment contract. There is not an overarching investment contract "scheme" when purchasers' expectations of profits (if any) arise primarily from factors other than "the efforts of others". Even in the early stages of relying on the safe harbor, there should be a clear and credible story of why, at maturity, the token's value drivers will be decentralized rather than coming from a single commercial enterprise.

[9] Strictly speaking, the extra language—"and not on the profits and losses or equity value of any single extrinsic enterprise related thereto"—is redundant, as the prior part of the condition in this clause will not be satisfied if there is such a dependence on profits/losses of an entity. However, to "gild the lily" on this point seems desirable to make extra clear what kinds of situations will *not* qualify for the safe harbor and to make any kind of 'end run' of the intended rule even less likely.

[10] This clause is needed to prevent pseudo-equity tokens during the safe harbor period itself. Otherwise, the development team could, for example, run a conventional business and regularly "buyback and burn" the token out of the business's profits, so long as they only do it during the safe harbor period.

(46) The initial development team files a notice of reliance in accordance with paragraph (c) of this section.

(57) ~~An~~ The initial development team files an exit report ~~is filed~~ in accordance with paragraph (f) of this section.

(b) Disclosure. The initial development team must provide the information described below on a freely accessible public website.

(1) *Initial Disclosures.* Prior to filing a notice of reliance on the safe harbor, provide the following information. Any material changes to the information required below must be provided on the same freely accessible public website as soon as practicable after the change.

(i) *Source Code.* For Tokens planned to reach Token Maturity based on their connection to an Autonomous System[11]: a~~A~~ text listing of commands to be compiled or assembled into an executable computer program used by ~~network~~Autonomous System participants to access the ~~network~~Autonomous System, amend the code, and confirm transactions.

(ii) *Transaction History*. For Tokens planned to reach Token Maturity based on their connection to an Autonomous System[12]: a~~A~~ narrative description of the steps necessary to independently access, search, and verify the transaction history of the ~~network~~Autonomous System.

(iii) *Token Economics.* A narrative description of the purpose of the ~~network~~Autonomous System (if applicable), the Qualifying Consumer Application (if applicable), the Token, ~~the protocol,~~ and ~~its~~the governance and operation of the foregoing. At a minimum, such disclosures must include the following:

(A) 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;

[11] Utility tokens within a Qualifying Consumer Application do not have to entail full code disclosure.

[12] Utility tokens within a Qualifying Consumer Application do not have to entail full independent auditability/verifiability.

(B) Information detailing the method of generating or mining Tokens, the process for burning Tokens (if applicable), the process for validating transactions (if applicable), and the consensus mechanism (if applicable);

(C) An explanation of governance mechanisms for implementing changes to the ~~protocol~~Autonomous System or Qualifying Consumer Application; and

(D) For Tokens planned to reach Token Maturity based on their connection to an Autonomous System, s~~S~~ufficient information for a third party to create a tool for verifying the transaction history of the Token (*e.g.*, the blockchain or distributed ledger).

(E) For Tokens planned to reach Token Maturity based on their connection to an Autonomous System , a ~~A~~ hyperlink to a block explorer, and for Tokens planned to reach Token Maturity based on their connection to a Qualifying Consumer Application, any other reasonably reliable method of confirming Token balances, Token supply, and other key metrics for the Token.

(iv) *Plan of Development.* The current state and timeline for the development of the ~~network~~Autonomous System or Qualifying Consumer Application to show how and when the initial development team intends to achieve ~~Network Maturity~~Token Maturity.

(v) *Prior Token Sales.* The date of sale, number of Tokens sold prior to filing a notice of reliance on the safe harbor, any limitations or restrictions on the transferability of Tokens sold, and the type and amount of consideration received.

(vi) *initial development team and Certain Token Holders*. Furnish the following information.

(A) The names and relevant experience, qualifications, attributes, and skills of each person who is a member of the initial development team who directly or indirectly beneficially owns or has the right to receive or control 1% or more of the total maximum possible supply of the Tokens (an "Executive Developer");

(B) The number or percentage of the total maximum possible supply of Tokens or rights to Tokens owned by ~~each member of~~ the initial development team and a description of any vesting or forfeiture agreements with respect thereto and any limitations or restrictions on the transferability of Tokens held by such persons;

(C) 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 vesting or forfeiture agreements with respect thereto and any limitations or restrictions on the transferability of such Tokens; and

(D~~C~~) If any member of the initial development team or Related Person 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

(E) Copies of all material agreements involving the initial development team, any one or more of the initial development team, any of its members or, to the extent known to the initial development team, any of their respective related persons, in each case, that relate in any material respect to the Tokens, Blockchain System, or Qualifying Consumer Application, as applicable, including any agreements relating to the voting of Tokens, participation in any consensus mechanisms or other operations of the applicable Blockchain System, or agreements regarding usage or subsidization of the applicable Blockchain System or Qualifying Consumer Application or market-making in the Token.

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

(viii) *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)(1)(vi)(B) 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.

(ix) *Related Person Transactions.* A description of any material transaction, or any proposed material transaction, in which the initial development team is a participant and in which any Related Person 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.

(x) *Warning to* Token *Purchasers.* A statement that the purchase of Tokens involves a high degree of risk and the potential loss of money and a description of the principal risks of hacks, exploits, governance conflicts, downtime events, and loss of funds in connection with the Tokens and related Autonomous System or Qualifying Consumer Application.

(xi) Security Process and Audits. A detailed description of security processes related to the research, development and ongoing operation of the Blockchain System or Qualifying Consumer Application, including, if applicable, detailed descriptions of any security councils or security teams expected to monitor the Blockchain System or Qualifying Consumer Application over time and copies of all third party code security audits obtained by the initial development team.

(2) *Semiannual Disclosures.* Every six months following the date of filing the notice of reliance, pursuant to paragraph (c) of this section, until the end of the three-year period or a determination that ~~Network Maturity~~Token Maturity has been reached, whichever occurs first, provide updated information required by paragraph (b)(1)(iv) of this section as of the end of the six-month period. These updates must be made within 30 calendar days after the end of the semiannual period.

(c) Filing of Notice of Reliance. The initial development team must file a notice of reliance on the safe harbor prior to the date of the first Token sold in reliance on the safe harbor.

(1) The notice of reliance must contain the following information:

(i) The name of each individual on the initial development team;

(ii) Attestation by a person duly authorized by the initial development team that the conditions of this section are satisfied;

(iii) The website where disclosure required under paragraph (b) may be accessed; and

(iv) An email address at which the initial development team can be contacted.

(2) A notice of reliance must be filed with the Commission in electronic format through 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 the notice of reliance was filed.

(f) Exit Report. An exit report must be filed no later than the date of expiration as calculated in paragraph (e) of this section.

(1) The exit report must contain the following information:

(i) A detailed description showing that any material undertakings (research and development plans, etc.) of the initial development team that were provided in the initial disclosures, any subsequent disclosures or otherwise publicly provided to or for the benefit of Tokenholders, either have been completed or have been superseded or become moot.

(ii) If ~~Network Maturity~~Token Maturity has been reached for a decentralized ~~network~~Autonomous System, an analysis by outside counsel or the initial development team[13] must be provided. The analysis should include:

(A) A description of the extent to which decentralization has been reached across a number of dimensions, including voting power, development efforts, and ~~network~~Autonomous System participation. If applicable, the description should include:

(1) Examples of material engagement on ~~network~~Autonomous System development and governance matters by parties unaffiliated with the initial development team.

(2) Explanations of quantitative measurements of decentralization.

(B) An explanation of how ~~the~~condition "(4)" of the Initial Disclosures described above has in fact been fulfilled. initial development team~~'s pre-Network Maturity~~Token Maturity~~ activities are distinguishable from their ongoing involvement with the network.~~ The explanation should:

[13] We have added the option for the initial development team to provide the analysis. Given the weighty legal consequences to the disclosure, we expect most teams would opt for outside counsel to provide the analysis; however, requiring outside counsel could result in price-gouging/cartelism by law firms and provide no realistic option for 'lean teams'. Since we are attempting to encourage decentralization, that means we are encouraging lean teams that may not have expansive budgets to hire lawyers to provide this analysis. Moreover, lawyer-designed automation tools could emerge from this–the analysis would then not be 'from outside counsel' but may still be very high-quality and informed by lawyers' general judgements.

(1) Discuss ~~the extent to which~~ the initial development team's continuing activities~~[~~, if any with respect to the Autonomous System or Tokens~~would not reasonably be expected to depend primarily on such activities] [RECONSIDER] are more limited in nature and cannot reasonably be expected uniquely to drive an increase in the value of the Tokens~~;

(2) Confirm that the initial development team has no material information about the ~~network~~Autonomous System that is not publicly available or describe the initial development team's policies and procedures for handling any such material non-public information it may currently have or acquire in the future in connection with the following clause '(3)'; and

(3) Describe the steps taken to communicate to the ~~network~~Autonomous System the nature and scope of the initial development team's continuing activities.

(ii) If ~~Network Maturity~~Token Maturity has been reached for a functional Token within a ~~network~~Qualifying Consumer Application, an analysis by outside counsel or the initial development team must be provided. The analysis should:

(A) Describe the holders' use of Tokens for the transmission and storage of value ~~on the network~~within the Qualifying Consumer Application, the participation in the Qualifying Consumer Application, ~~an application running on the network~~, or otherwise in a manner consistent with the utility of the ~~network~~Token within the Qualifying Consumer Application.

(B) Detail how the initial development team's marketing efforts have been, and will be, focused on the Token's consumptive use, and not on speculative activity.

(C) Include an explanation of how condition "(4)" of the Initial Disclosures described above has in fact been fulfilled.

(iii) If the initial development team determines that ~~Network Maturity~~Token Maturity has not been reached and no other party has filed an exit report, the following information must be provided:

(A) The status of the project and the next steps the initial development team intends to take.

(B) Contact information for Token holders to communicate with the initial development team.

(C) If the Tokens or any contracts, transactions or scheme relating to the Tokens are unregistered and non-exempt securities, a~~A~~ statement acknowledging that the Initial Development team will file a Form 10 to register under Section 12(g) of the Securities Exchange Act of 1934 the Tokens (or the relevant contracts, transactions or scheme constituting an investment contract)[14] as a class of securities within 120 days of the filing of the exit report.[15]

(2) The exit report must be filed with the Commission in electronic format through EDGAR in accordance with EDGAR rules set forth in Regulation S-T.

(g) Transition Period for Trading Platforms. No trading platform shall be subject to the requirements of Section 6 of the Exchange Act due to activity related to the trading of Tokens subject to a determination pursuant to paragraph (f)(iii) of this section, provided that the trading platform prohibits such trading within six months of such determination.

(h) Tokens Previously Sold. An initial development team that prior to the effective date of this rule sold Tokens pursuant to a valid exemption from registration or sold in violation of Section 5 of the Securities Act of 1933 as determined in a Commission order pursuant to Section 8A of the Securities Act of 1933 that does not identify any other violations of the federal securities laws may rely on this section if the conditions of paragraph (a) are satisfied. The notice of reliance required by paragraph (c) of this section must be filed as soon as practicable.

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

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[14] Generally it may still be unlikely that the individual tokens *are* securities, thus this language is added to allow for registration of the relevant investment contracts, whatever they may be.

[15] More thought should be given on how to handle the scenario where Token Maturity has not been achieved, and what the exact securities at issue may be. If Token Maturity has not been achieved, then it is likely that the Tokens are part of a "scheme" that constitutes an investment contract, but are not necessarily individual securities. The current registration forms and rules are not geared toward registration of an investment contract scheme, but rather to registration of individual express securities. In general, the Howey test is really geared toward rescission remedies rather than identifying registrable securities, and thus when the safe harbor fails to be completed, perhaps a rescission remedy or a managed process of 'unwinding' of the securities scheme may be more appropriate than a registration-based solution. This, however, raises many legal and policy issues, so we have chosen not to grapple with it in this proposal.

(j) Disqualifications. No exemption under this section is available for the Tokens of any initial development team if it or its individual members would be subject to disqualification under Rule 506(d).

(k) Definitions.

(1) *initial development team*. Any person, group of persons acting in concert, or entity that provides the essential entrepreneurial and managerial efforts for the development of the ~~network~~Autonomous System prior to reaching ~~Network Maturity~~Token Maturity and makes the initial filing of a notice of reliance on this safe harbor.

(2) ~~*Network Maturity*~~*Token Maturity*. ~~Network Maturity~~Token Maturity may be achieved for a Token in either of the following ways:~~is the status of a decentralized or functional network that is achieved when the network is either:~~

(i) ~~(i)~~ The value of the Token primarily correlates to or depends on the usage or adoption of an Autonomous System that is governed by and/or integrally uses the Token for its operation or security, where "Autonomous System" refers to a Blockchain System that is n~~N~~ot economically or operationally controlled and is not reasonably likely to be economically or operationally controlled or unilaterally changed by any single person, entity, or group of persons or entities under common control, except that ~~network~~Autonomous Systems for which the initial development team owns more than 20% of Tokens or owns more than 20% of the means of determining ~~network~~Autonomous System consensus or governance cannot satisfy this condition. The definition is not meant to preclude Autonomous System alterations achieved through a predetermined procedure in the source code that uses a consensus mechanism among all or a subset of Autonomous System participants (which may include voting power associated with the Tokens). Notwithstanding the foregoing, "layer-2" Blockchain Systems that are verifiable with reference to the data stored on, provide a guaranteed power of exit to, and are susceptible of forced-transaction-inclusion from, a "layer-1" Blockchain System satisfying the test for 'Autonomous System' set forth in the preceding part of this clause '(i)', shall also be deemed Autonomous Systems and may create a basis for the Token Maturity of a Token the value of which primarily correlates to or depends on the usage or adoption of such "layer-2" Blockchain System or any additional Blockchain System deployed thereon, provided that the maximum ownership threshold summarized above and the other relevant conditions for obtaining Token Maturity in connection with an Autonomous System set forth in this Rule 195 are satisfied.

or

(ii) The value of the Token primarily arises from or correlates to or depends on the usage or adoption of a Qualifying Consumer Application and the Token's usage or functionality in connection therewith, ~~Functional,~~ as demonstrated by the holders' use of Tokens for the transmission and storage of value ~~on the network~~within the Qualifying Consumer Application, the participation in the Qualifying Consumer Application~~an application running on the network~~, or otherwise in a manner consistent with the utility of the ~~network~~Qualifying Consumer Application. "Qualifying Consumer Application" means a software application or other product or service which relies in whole or in part for its end-user licensing, end-user access, pricing, distribution, or functionality on the usage of a Token as an application access credential, an in-application virtual currency or a points, discount, rebate or credit accrual measure, or similar mechanism, and whose independent market value or pricing, if any, does not primarily arise from a correlation to the profits and losses of the application operator or developer from owning, running, or sponsoring the application or the other enterprises or businesses of the operator or developer.

(3) Qualifying Transaction. Qualifying Transaction means any offer, sale, or transaction forming a part of or pursuant to:

(i) the public distribution or allocation of Tokens, in one or a series of transactions,:

(A) (i) in exchange for or recognition of or incentive for or facilitation of past or future usage of such Autonomous System or Qualifying Consumer Application; or (ii) as a reward or incentive for conducting activities primarily related to operating, governing or securing the related Autonomous System, such as mining, validating, staking, performing system liquidations, storing or publishing data, or maintaining the availability of decentralized interfaces for or tools for facilitating usage of the Autonomous System.~~; or~~

(B) to any governance system for the related Autonomous System that is controlled primarily by holders of the Tokens or other users of the Autonomous System[16]; or

(ii) the private distribution or allocation of any Tokens, in one or a series of transactions, to members of the initial development team or to other persons primarily as a reward or

[16] Intended to cover DAO smart contracts or token-governed legal entities through which issued/outstanding governance tokens vote on the use of unissued/treasury governance tokens.

incentive for researching, developing, promoting, marketing, educating, providing professional services with respect to, or coordinating offchain activities with respect to, the related Autonomous System or Qualifying Consumer Application;[17]

(iii) any offer or sale of the Tokens on an open secondary market, where there is no agreement between the purchaser and the seller for the seller to pool the proceeds of sale of the Tokens for use as risk capital for entrepreneurial efforts benefitting the purchaser;[18] or

(iv~~iii~~) any transaction that is otherwise exempt from the registration requirements of Section 5 of the Securities Act of 1933.

(4~~3~~) *Related Person*. Related person means the initial development team, directors or advisors to the initial development team, and any immediate~~ly~~ family member of such persons.

(5) "Blockchain" means a distributed data structure consisting of hashlinked sets ('blocks') of transactions.

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[17] This reflects the holding on service provider token incentives in SEC v. Ripple.

Moreover, from a policy perspective, exempting 'team token rewards' makes sense. Initial development teams for Blockchain Systems tend to be relatively small & intimate. People who work on these systems will be very well informed about, and have a material role in shaping, the risks and benefits of the Tokens and the related Blockchain Systems and applications. The team can be seen as more of a partnership (which, under Williamson and other cases, creates a presumption of non-securities status) for the creation of the token. From a policy perspective, this is very different from large corporate enterprises like pre-IPO Google that the SEC has historically focused its securities-incentive-compensation policy and enforcement actions around and where employees may be in a position more similar to outside investors and have an important interest in receiving information such as detailed financial statements of their employer.

[18] This reflects the holding on "programmatic sales" in *SEC v. Ripple.* We are aware of other proposals (which we generally consider thoughtful) that seek to exclude initial development team and/or early private investors from sales of tokens into the secondary market, until the point when Token Maturity is achieved. While we understand are sympathetic to many of the policy concerns around this (early dumping of tokens onto 'retail' without having completed key work), there are counterpoints: (a) either the *Ripple* holding on programmatic sales is wrong, or such sales are allowed under current law—assuming the *Ripple* holding is wrong may be controversial; (b) one of the most deleterious features of current crypto market structure for 'retail' is the "low-float, high-FDV" phenomenon that is driven in part by long team/investor lockups and delayed public liquid market price discovery; (c) the free market can evolve lockup practices in various ways, for example by punishing the performance of early-dumped tokens or by VCs who wish to ensure the teams they invest build 'for the long haul' imposing contractual lockups on those teams when they invest; and (d) requiring achievement of Token Maturity before tokens can be sold by the team / investors into the secondary market on a programmatic basis will favor VC-backed teams that can raise through Reg D rounds to build a long-lasting warchest over "bootstrappy" teams that choose to run lean and wish to maximize distribution to "retail" in the public markets. All that being said, we could see potential merit to a mandatory lockup proposal if it is at least as permissive as existing exemptions around restricted securities that are not control securities (including ability to take advantage of a modified form of Rule 144, sales to Qualified Purchasers, sales to accredited investors, 4(a)(7), 4(a)(1)(1/2), etc.), but if such an approach is taken, it should also require public disclosure of the terms of the permitted private-market 'pre-unlock' secondary sales so that a "bullish unlock" phenomenon is possible and the current low-float/high-FDV adverse market structure may be corrected over time. (*See* Cobie, "On the meme of market caps & unlocks", https://cobie.substack.com/p/on-the-meme-of-market-caps-and-unlocks).

(6) "Blockchain System" means either

(i) the combination of:

(A) a Blockchain; and

(B) a network of one or more devices operating software clients or software applications that jointly or individually store, validate, process transactions with respect to, update, resolve forks with respect to or otherwise maintain, validate, read from, store data with respect to, create; or

(ii) any executable bytecode (commonly known as 'smart contracts') deployed to a Blockchain System of the kind described in clause '(i)' above for operation by node operators running validators, sequencers or similar network operators on such Blockchain System.[19]

(5~~4~~) *Token*. A Token means any virtual currency, token, or other unit of account or medium of exchange that is implemented exclusively or primarily on a Blockchain System, regardless of whether transferable, non-transferable, fungible or non-fungible~~is a digital representation of value or rights~~[20]

~~(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) cannot be modified;~~

~~(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.~~

[19] The Safe Harbor 2.0 Proposal's language seemed predicated on talking about "networks" which basically seemed to be what we now commonly call "L1s". An L1 can be decentralized/autonomous, but so can a set of smart contracts built on top of the L1 (for example, a DeFi "protocol") or another, less decentralized blockchain that "borrows security" from the L2 (e.g., an L2, L3,ec.). It is very important that the term "Blockchain System" does not only encompass "networks" (of all kinds—L1s, L2s, L3s) but also smart contract systems built on top of those "networks".

[20] Note that this definition deliberately departs from the legally common but technologically unintelligible definition of a token as a 'representation of value'. Most tokens have value, but few 'represent value' as, unlike stock certificates etc., they are non-semiotic.

(6) "extrinsically affiliated" means, with respect to any two persons, any Blockchain System and any Tokens related to such Blockchain System, that: (a) due to arrangements or agreements outside of the Blockchain System (such as ownership of one person's equity securities by another or common ownership of a third person's equity securities), 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 management, operation, use or control of influence over the Blockchain System; or (b) such persons have agreed to act in concert for the purpose of acquiring, holding, voting, using or disposing of the Tokens or managing, operating, using or controlling or influencing the Blockchain System; provided, however, that two persons independently using or agreeing to use the Tokens for their intended purposes within the Blockchain System (such as by independently contracting with the initial development team to participate in a proof-of-stake consensus process that results in agreement among stakers or validators, or to regularly independently vote on Blockchain System governance proposals) shall not, in itself, constitute extrinsic affiliation.

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 marketplace 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 Investment Company Rule 3a-10. Exemption from investment company status for Autonomous Systems

Notwithstanding section 3(a) of the Act, an Autonomous System (as defined in Rule 195 of the Securities Act of 1933) will be deemed not to be an investment company.[21]

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.

[21] It's possible this may be more appropriate for a later DeFi-specific proposal, but decided to add it in here as a discussion point. It is needed because the SEC threatened to characterize many fully decentralized/autonomous DeFi systems (even governance-minimized ones) as investment companies. *See* e.g. "*Why did I quit in 2022*" -Andre Cronje, https://andrecronje.medium.com/why-did-i-quit-in-2022-e9a3a6ae91ef On the other hand, we understand that facts/circumstances like the original TheDAO likely should be considered investment companies if not otherwise exempt (especially if they invest in securities) and do not intend to exclude those.

HYPOTHETICAL APPLICATIONS OF FACTS TO PROPOSAL 3

The following are some examples of Tokens and how they would play out under the above tests. They are *heavily* inspired by real-world cases found in the crypto ecosystem.

1. **"Buyback and burn CEX token"**

   Facts: A CEX has issued a token under the CEX's brand that is generally considered to be 'the official token' of this CEX. Every month, the CEX applies 10% of its gross revenues from all sources to buying back and burning the token. A strong correlation can be observed in the market between the token price at a given time and the CEX's gross revenues over the current or preceding period.

   Result during the 'safe harbor' period: The token does not qualify for the safe harbor because it fails condition #5–i.e., prior to Token Maturity being achieved, managerial efforts of the initial development team consist of general business activities the profits and losses of which are reasonably expected to correlate with the profits and losses from purchases and sales of the Token.

   Result at the end of the 'safe harbor' period: The token has not achieved Token Maturity because it fails condition #4–i.e., the value of the token depends primarily on the profits and losses or equity value of a single extrinsic enterprise related thereto (the CEX).

   For a similar case, *see SEC v. SG Ltd.,* 265 F.3d 42 (1st Cir. 2001) (online "StockGeneration" club found to meet Howey test).

2. **"Perks CEX token"**

   Facts: A CEX has issued a token under the CEX's brand that is generally considered to be 'the official token' of this CEX. Customers who hold the token (or a certain minimum number of the tokens) in their accounts may receive various benefits, including discounted trading fees, access to purchasing pre-listed tokens, CEX-branded swag/merchandise, access to exclusive IRL events, and more of the same type of the CEX's token as a reward for certain activities of a particular user such as that user meeting minimum monthly trading volumes. The CEX does not have a buyback-and-burn or similar program such as referred to in Example #1 but may occasionally make *ad hoc* purchases of its own token on the market or OTC, either to stabilize the market or to have more tokens to distribute to customers. The price performance of the token over time does not appear to be strongly correlated with these incidental purchases and the market does not appear to have a general expectation of ongoing purchases by the CEX.

   Result: The token qualifies for the safe harbor and can achieve Token Maturity because it passes condition #4 and condition #5 as a token connected with a Qualifying Consumer Application. It is possible that the CEX may have to cease or reduce its sporadic buybacks of the Token to achieve Token Maturity, depending on their size and impact–perhaps the purchases were justifiable during

the safe harbor period to stabilize market price and encourage adoption but may become less justified in the post-safe-harbor-period of Token Maturity.

3. **"Buyback-and-burn or buyback-and-redistribute DEX token"**

Facts: A decentralized autonomous DeFi exchange (DEX) consisting of smart contracts on Ethereum is linked to a governance token with the same branding as the DEX which governs certain parameters of the DEX (such as fees charged to swappers and paid to liquidity providers). A percentage of the fees charged to swappers is programmatically and automatically re-routed by the smart contracts to buying the governance token from a pool dedicated to the governance token on the same or another DEX. The programmatically purchased governance tokens are then programmatically "burned"--i.e., the smart contracts transfer the Tokens to the well-known Ethereum "burn address" (a public key on Ethereum for which there is no corresponding private key and which is thus inaccessible to anyone, effectively making any Tokens held by this account destroyed). Over time, this reduces the supply of the governance token, and, assuming the governance token has other independent value drivers (e.g., there may be demand by DEX traders or liquidity providers to hold it so that they can influence the parameters of the system they run their trading businesses on), the reduction in supply may drive increase in prices of the governance token on the open market. Alternatively, the purchased tokens may be re-distributed to "stakers" in exchange for governing the DEX, rather than being "burned"--this results in both an economic reward (income) to the active governance participants and re-distributes additional governance power to those participants over time. The initial development team owns less than 20% of the governance token and has no special administrative or other privileges over the DEX and does not share the revenues of any extrinsic business with tokenholders or use such revenues to buyback the token–only the fees generated by the autonomous functioning of the DEX contribute to token buybacks.

Result: The token primarily derives its value from its connection with the Autonomous System and the other criteria of Token Maturity are satisfied, thus the safe harbor applies.

4. **"inactive-fee-switch DEX governance token w/ DevCo"**

Facts: A decentralized autonomous DeFi exchange (DEX) consisting of smart contracts on Ethereum (not modifiable/censorable by anyone) is linked to a governance token with the same branding as the DEX and an associated venture-backed development company which directly or indirectly issued the token. The only functions of the governance token is to decide how unissued governance tokens are spent, whether the DEX software will be licensed by the development company to third parties or for deployment on other blockchains, and to set a "fee switch" on the DEX that may apportion some DEX fees to a treasury contract controlled by the governance tokens. The governance token is generally marketed by the development company as being "valueless". The employees and investors of the development company consistently avoid voting in favor of turning on the "fee switch" and, meanwhile, the development company makes proprietary revenues from running interfaces for the DEX. The voting thresholds for the governance tokens are so high

that it is impossible to approve the fee switch activation without participation by the employees and investors of the development company. The development company continues to research, develop and deploy new and improved versions of the DEX, and it has been observed that price spikes in the token occur whenever a new version is announced or deployed.

Result during the safe-harbor period: The token may potentially qualify for the safe harbor, as long as the initial development team can justify that it is diligently working toward a state of affairs where the fee switch can be activated–or other utilities for the token can be created–and that at that point the token's value will primarily arise from "the DAO's" share of DEX fees or those other utilities. Although the development company has its own business model and revenues relating to the DEX, it is not tying those to the tokens, and the mere fact that the token price increases with new releases driven by the labs company's research and development does not mean the token is tied to those development efforts–it could be that the market is still pricing in the potential fee switch activation, and believes that the new version of the software has higher fee-earning potentials for "the DAO" rather than pricing the token based on future efforts of the development company.

Result after the safe-harbor period: The token cannot qualify for Token Maturity until the fee-switch is activated (along with any other utilities that may have arisen in the meantime) or the token ownership of the team/investors is reduced to a level where they can no longer 'block' approval of the fee switch activation. Without these mechanisms, the value of the Token will *not* primarily be based on the Token's utility, consumptive purpose, general market forces, the efforts of a widely dispersed group of non-extrinsically-affiliated persons, or the adoption of the Blockchain System to which it is related, or any combination of the foregoing factors, because the predominant factor in whether the token can have any of those value drivers will remain whether the initial development company and its investors will ever vote in favor of activating the fee-switch mechanism. A more legalistic way of thinking about this is that the 'investment contract' undertakings of the initial development team are incomplete–the market bought based on the expectation of value-sharing through the fee switch and unless the initial development team and its investors approve activating it, the basic 'undertakings' promised by the development team have not been completed, the implicit 'investment contract' remains executory and thus the investment contract "scheme" remains in effect and must be either registered or exempt–but the Rule 195 exemption no longer applies, since the functionality has not been activated within the safe harbor period .

5. "active-fee-switch DEX governance token"

Facts: Same as above, except fees flow to "the DAO" (controlled by governance tokens) programmatically from the DEX from day 1 rather than this functionality being gated by a 'fee-switch activation. The governance tokenholder voting also controls some other parameters of the DEX, such as which DEX pools receive additional governance token emissions as a reward/incentive mechanism. Team/investors own less than 20% of all governance tokens and less than 20% of the voting power of the DAO.

Result: The token has achieved Token Maturity. The DEX is an Autonomous System, and the Token's value arises primarily from its relationship to that Autonomous System.

6. **"NFT art collectible with no utility"**

   Facts: An NFT is marketed and sold as a pure 'art collectible,' based on the metadata storing art that is meant to make the NFT value based on provable provenance, associate IP rights in the art granted to the tokenholder, or exclusivity (e.g., a covenant by the artist never to release the art in any other format). The art is presented as unique 'fine art' to be appreciated based on its aesthetics. There are no material current or future utilities, perquisites, 'club memberships', or similar features associated with the NFT.

   Result: The NFT does not need the safe harbor, as it is not a security and not associated with any potential contract, transaction, or scheme that constitutes an investment contract.

7. **"NFT PFP-style art collectible with club membership"**

   Facts: An NFT is marketed and sold as a hybrid art collectible & 'club membership.' The NFT art represents a PFP character type constituting one of a series of similar characters and may or may not be associated with any IP rights, provenance claims, or exclusivity commitments. (The art itself may even have a Viral Public License[22] so that the NFT holder has no special rights in the art.) Holders of the NFT gain membership in an IRL or digital 'club', which may include receiving exclusive or preferred event access, frequent or frequently expected "airdrops" of other tokens, admittance to special chat rooms, exclusive or preferred access to other applications, discounts to products and services, etc. There is an initial development team who are regularly arranging these matters (with varying participation from prominent holders of the NFTs) to ensure that the NFT holders continue to get great benefits and the community stays strong. The initial development team partly uses proceeds from the initial sale of NFTs and/or continued fees earned from market-making with pre-mined NFTs to support these efforts (paying salaries to the contributors, paying for event space, etc.).

   Result: The NFT needs the safe harbor because the fact pattern implicates many *Howey* cases where an investment contract was found as part of club membership, such as *Teague v. Bakker* (and, in blue sky cases, analogous non-*Howey* results such as *Silver Hills Country Club v. Sobieski*, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961)). The NFT should qualify for the safe harbor based on the club being a Qualifying Consumer Application and the efforts of the team being oriented around the NFT itself rather than tying the NFT to a particular extrinsic business enterprise.

8. "NFT PFP-style art collectible with club membership, including referral rewards tied to the success of a complementary business"

[22] https://viralpubliclicense.org/

Facts: Same facts as above, but the primary membership features are focused around a specific IRL club promotion company, Diamonds Entertainment, that preexisted the NFTs. The NFT sales proceeds were used to finance new construction projects of Diamonds. The NFTs get you benefits at all of DE's casinos, nightclubs, and youth-lifestyle apartment buildings, and are associated with a 'referral system' in which prior owners of an NFT receive a percentage of all the spending done by the subsequent NFT owners. There are promotional materials that strongly encourage NFT holders to "grow the Diamond family" by recruiting new NFT holders and sharing in the general spending of those NFT holders within Diamond businesses.

Result: The NFT does not qualify for the safe harbor, because it is tied too closely to Diamond's general extrinsic business enterprise and approaches the status of a 'proxy equity' of Diamonds. This tracks multilevel-marketing *Howey* cases such as SEC v. Int'l Loan Network, Inc., 770 F. Supp. 678 (D.D.C. 1991) (membership-based pyramid scheme enjoined as offering of investment contracts) and SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974) (multi-level marketing memberships held securities, reversing lower court)

CLEAN COPY OF PROPOSAL 3

Proposed Securities Act Rule 195. Time-limited exemption for Certain[23] Blockchain Tokens.

(a) Exemption. Except as expressly provided in paragraph (d) of this section, the Securities Act of 1933 does not apply to any Qualifying Transaction[24] involving a Token if the following conditions are satisfied by the initial development team, as defined herein.

(1) The initial development team intends for the Token to reach Token Maturity[25] within three years of the date of the first sale of Tokens and makes continuous good faith commercially reasonable efforts to achieve such Token Maturity within such three-year period[26];

(2) Disclosures required under paragraph (b) of this section are made available by the initial development team[27] on a freely accessible public website.

[23] Due to the definition of "Qualifying Transactions" and certain other features of the proposal, not all types of blockchain tokens will qualify for the exemption, even if they are not 'intrinsic securities'. For example, a Token that is regularly 'bought and burned' as a fixed percentage of a centralized business' profits, would not qualify for the exemption, as this is essentially a pseudo-equity security based on the circumstances, even though it is not 'intrinsically' so (since it does not have specific rights).

[24] The exemption is limited to "Qualifying Transactions" because risk-capital-raising transactions are generally understood to constitute "contracts" or "transactions" that constitute investment contracts under *Howey* and thus should only qualify if they are otherwise exempt. Additionally, certain non-risk-capital-raising transactions may nevertheless be part of a "scheme" that constitutes an investment contract under *Howey. (See* SEC v. Telegram). The definition of "Qualifying Transaction" seeks to capture these nuances.

[25] In the original Safe Harbor 2.0 Proposal, the term "Network Maturity" uneasily combined aspects of a decentralized autonomous system and a 'utility token' intended for consumptive purposes. To make the handling of this issue more clear, we use the term "Token Maturity" instead—a Token can be mature if it relates to a decentralized autonomous system, but can also be mature if it is a 'utility' token within a consumer application, even if that application is centralized.

[26] The added language is intended to require more than just an initial statement of an intention to decentralize or create utility. Rather, there must be *bona fide* efforts throughout the safe harbor period to actually fulfill the intention.

[27] Generally, it seems best if there is a single reporting entity providing a consolidated report. Adding 'by the initial development team' here and elsewhere clarifies this. Of course, one could in theory take a more "MiCa-like" approach in which any party could provide disclosure for any token; however, this becomes complicated and may create risks of not having a clear party to hold responsible for problems. We also believe that basically every token project does initially have a clear initial development team and thus do not see significant risk with this.

(3) The Token is designed by the initial development team [28] for the purpose of facilitating access to, participation on, or the development of the Autonomous System or Qualifying Consumer Application[29].

(4) It is reasonably expected that, when Token Maturity is achieved, the value of the Token will primarily be based on the Token's utility, consumptive purpose, general market forces, the efforts of a widely dispersed group of non-extrinsically-affiliated persons, or the adoption of the Blockchain System or Qualifying Consumer Application to which it is related, or any combination of the foregoing factors,[30] and not on the profits and losses or equity value of any single extrinsic enterprise related thereto[31].

(5) It is reasonably expected that, prior to Token Maturity being achieved, any managerial efforts of the initial development team will primarily be intended in good faith to achieve Token Maturity during the three-year safe harbor period (e.g., by completing functionality of the Autonomous System or Qualifying Consumer Application or encouraging sufficient adoption of an Autonomous System allow the system to run on a decentralized basis), rather than on conducting general business activities the profits and losses of which would reasonably be expected to correlate with the profits and losses from purchases and sales of the Token[32].

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[28] The "offered and sold" language in the prior version was unclear in a few ways. On its face it potentially applied to *any offeror* or seller of the token, but presumably a third party who sells a token in some other way should not cause a loss of the exemption for the initial development team. The prior language was unclear on whether the token had to be *exclusively* offered and sold for utility purposes, or if just sometimes being sold for such purpose was enough. In contrast, the new language is cabined to the intentions of the initial development team; this creates more certainty, which in turn makes the exemption more reliable, and thus more valuable. Furthermore, the new language relates to the design of the token and thus its intrinsic features, but still allows the token to be offered and sold for other purposes (such as capital-raising) in early stages. Importantly, those other transactions will only be exempt under Rule 195 if they are already exempt under Regulation D or another conventional exemption.

[29] Keeping with the spirit of the Safe Harbor Proposal 2.0 but seeking greater clarity of implementation, we have broken the safe harbor paths into two. A Token can become "mature" if its value is primarily linked to an Autonomous System, but can also become "mature" if it is primarily a 'utility' token within a Qualifying Consumer Application. The former requires "decentralization", the latter does not.

[30] This clause is intended to capture the idea that, for a token to qualify for the Rule 195 exemption, transactions in the token generally must not constitute part of a "scheme" that is a *Howey* investment contract. There is not an overarching investment contract "scheme" when purchasers' expectations of profits (if any) arise primarily from factors other than "the efforts of others". Even in the early stages of relying on the safe harbor, there should be a clear and credible story of why, at maturity, the token's value drivers will be decentralized rather than coming from a single commercial enterprise.

[31] Strictly speaking, the extra language—"and not on the profits and losses or equity value of any single extrinsic enterprise related thereto"—is redundant, as the prior part of the condition in this clause will not be satisfied if there is such a dependence on profits/losses of an entity. However, to "gild the lily" on this point seems desirable to make extra clear what kinds of situations will *not* qualify for the safe harbor and to make any kind of 'end run' of the intended rule even less likely.

[32] This clause is needed to prevent pseudo-equity tokens during the safe harbor period itself. Otherwise, the development team could, for example, run a conventional business and regularly "buyback and burn" the token out of the business's profits, so long as they only do it during the safe harbor period.

(6) The initial development team files a notice of reliance in accordance with paragraph (c) of this section.

(7) The initial development team files an exit report in accordance with paragraph (f) of this section.

(b) Disclosure. The initial development team must provide the information described below on a freely accessible public website.

(1) *Initial Disclosures.* Prior to filing a notice of reliance on the safe harbor, provide the following information. Any material changes to the information required below must be provided on the same freely accessible public website as soon as practicable after the change.

(i) *Source Code.* For Tokens planned to reach Token Maturity based on their connection to an Autonomous System[33]: a text listing of commands to be compiled or assembled into an executable computer program used by Autonomous System participants to access the Autonomous System, amend the code, and confirm transactions.

(ii) *Transaction History*. For Tokens planned to reach Token Maturity based on their connection to an Autonomous System[34]: a narrative description of the steps necessary to independently access, search, and verify the transaction history of the Autonomous System.

(iii) *Token Economics.* A narrative description of the purpose of the Autonomous System (if applicable), the Qualifying Consumer Application (if applicable), the Token, and the governance and operation of the foregoing. At a minimum, such disclosures must include the following:

(A) 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;

(B) Information detailing the method of generating or mining Tokens, the process for burning Tokens (if applicable), the process for validating transactions (if applicable), and the consensus mechanism (if applicable);

[33] Utility tokens within a Qualifying Consumer Application do not have to entail full code disclosure.

[34] Utility tokens within a Qualifying Consumer Application do not have to entail full independent auditability/verifiability.

(C) An explanation of governance mechanisms for implementing changes to the Autonomous System or Qualifying Consumer Application; and

(D) For Tokens planned to reach Token Maturity based on their connection to an Autonomous System, 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).

(E) For Tokens planned to reach Token Maturity based on their connection to an Autonomous System , a hyperlink to a block explorer, and for Tokens planned to reach Token Maturity based on their connection to a Qualifying Consumer Application, any other reasonably reliable method of confirming Token balances, Token supply, and other key metrics for the Token.

(iv) *Plan of Development.* The current state and timeline for the development of the Autonomous System or Qualifying Consumer Application to show how and when the initial development team intends to achieve Token Maturity.

(v) *Prior Token Sales.* The date of sale, number of Tokens sold prior to filing a notice of reliance on the safe harbor, any limitations or restrictions on the transferability of Tokens sold, and the type and amount of consideration received.

(vi) *initial development team and Certain Token Holders*. Furnish the following information.

(A) The names and relevant experience, qualifications, attributes, and skills of each person who is a member of the initial development team who directly or indirectly beneficially owns or has the right to receive or control 1% or more of the total maximum possible supply of the Tokens (an "Executive Developer");

(B) The number or percentage of the total maximum possible supply of Tokens or rights to Tokens owned by the initial development team and a description of any vesting or forfeiture agreements with respect thereto and any limitations or restrictions on the transferability of Tokens held by such persons;

(C) 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 vesting or forfeiture agreements with respect

thereto and any limitations or restrictions on the transferability of such Tokens; and

(D) If any member of the initial development team or Related Person 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

(E) Copies of all material agreements involving the initial development team, any one or more of the initial development team, any of its members or, to the extent known to the initial development team, any of their respective related persons, in each case, that relate in any material respect to the Tokens, Blockchain System, or Qualifying Consumer Application, as applicable, including any agreements relating to the voting of Tokens, participation in any consensus mechanisms or other operations of the applicable Blockchain System, or agreements regarding usage or subsidization of the applicable Blockchain System or Qualifying Consumer Application or market-making in the Token.

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

(viii) *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)(1)(vi)(B) 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.

(ix) *Related Person Transactions.* A description of any material transaction, or any proposed material transaction, in which the initial development team is a participant and in which any Related Person 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.

(x) *Warning to* Token *Purchasers.* A statement that the purchase of Tokens involves a high degree of risk and the potential loss of money and a description of the principal risks of hacks, exploits, governance conflicts, downtime events, and loss of funds in connection with the Tokens and related Autonomous System or Qualifying Consumer Application.

(xi) Security Process and Audits. A detailed description of security processes related to the research, development and ongoing operation of the Blockchain System or Qualifying Consumer Application, including, if applicable, detailed descriptions of any security councils or security teams expected to monitor the Blockchain System or Qualifying Consumer Application over time and copies of all third party code security audits obtained by the initial development team.

(2) *Semiannual Disclosures.* Every six months following the date of filing the notice of reliance, pursuant to paragraph (c) of this section, until the end of the three-year period or a determination that Token Maturity has been reached, whichever occurs first, provide updated information required by paragraph (b)(1)(iv) of this section as of the end of the six-month period. These updates must be made within 30 calendar days after the end of the semiannual period.

(c) Filing of Notice of Reliance. The initial development team must file a notice of reliance on the safe harbor prior to the date of the first Token sold in reliance on the safe harbor.

(1) The notice of reliance must contain the following information:

(i) The name of each individual on the initial development team;

(ii) Attestation by a person duly authorized by the initial development team that the conditions of this section are satisfied;

(iii) The website where disclosure required under paragraph (b) may be accessed; and

(iv) An email address at which the initial development team can be contacted.

(2) A notice of reliance must be filed with the Commission in electronic format through 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 the notice of reliance was filed.

(f) Exit Report. An exit report must be filed no later than the date of expiration as calculated in paragraph (e) of this section.

(1) The exit report must contain the following information:

(i) A detailed description showing that any material undertakings (research and development plans, etc.) of the initial development team that were provided in the initial disclosures, any subsequent disclosures or otherwise publicly provided to or for the benefit of Tokenholders, either have been completed or have been superseded or become moot.

(ii) If Token Maturity has been reached for a decentralized Autonomous System, an analysis by outside counsel or the initial development team[35] must be provided. The analysis should include:

(A) A description of the extent to which decentralization has been reached across a number of dimensions, including voting power, development efforts, and Autonomous System participation. If applicable, the description should include:

(1) Examples of material engagement on Autonomous System development and governance matters by parties unaffiliated with the initial development team.

(2) Explanations of quantitative measurements of decentralization.

(B) An explanation of how condition "(4)" of the Initial Disclosures described above has in fact been fulfilled. The explanation should:

(1) Discuss the initial development team's continuing activities, if any with respect to the Autonomous System or Tokens;

(2) Confirm that the initial development team has no material information about the Autonomous System that is not publicly available or describe the initial development team's policies and procedures for handling any such material non-public information it may currently have or acquire in the future in connection with the following clause '(3)'; and

[35] We have added the option for the initial development team to provide the analysis. Given the weighty legal consequences to the disclosure, we expect most teams would opt for outside counsel to provide the analysis; however, requiring outside counsel could result in price-gouging/cartelism by law firms and provide no realistic option for 'lean teams'. Since we are attempting to encourage decentralization, that means we are encouraging lean teams that may not have expansive budgets to hire lawyers to provide this analysis. Moreover, lawyer-designed automation tools could emerge from this–the analysis would then not be 'from outside counsel' but may still be very high-quality and informed by lawyers' general judgements.

(3) Describe the steps taken to communicate to the Autonomous System the nature and scope of the initial development team's continuing activities.

(iii) If Token Maturity has been reached for a functional Token within a Qualifying Consumer Application, an analysis by outside counsel or the initial development team must be provided. The analysis should:

(A) Describe the holders' use of Tokens for the transmission and storage of value within the Qualifying Consumer Application, the participation in the Qualifying Consumer Application, or otherwise in a manner consistent with the utility of the Token within the Qualifying Consumer Application.

(B) Detail how the initial development team's marketing efforts have been, and will be, focused on the Token's consumptive use, and not on speculative activity.

(C) Include an explanation of how condition "(4)" of the Initial Disclosures described above has in fact been fulfilled.

(iii) If the initial development team determines that Token Maturity has not been reached and no other party has filed an exit report, the following information must be provided:

(A) The status of the project and the next steps the initial development team intends to take.

(B) Contact information for Token holders to communicate with the initial development team.

(C) If the Tokens or any contracts, transactions or scheme relating to the Tokens are unregistered and non-exempt securities, a statement acknowledging that the Initial Development team will file a Form 10 to register under Section 12(g) of the Securities Exchange Act of 1934 the Tokens (or the relevant contracts, transactions or scheme constituting an investment contract)[36] as a class of securities within 120 days of the filing of the exit report.[37]

[36] Generally it may still be unlikely that the individual tokens *are* securities, thus this language is added to allow for registration of the relevant investment contracts, whatever they may be.

[37] More thought should be given on how to handle the scenario where Token Maturity has not been achieved, and what the exact securities at issue may be. If Token Maturity has not been achieved, then it is likely that the Tokens are part of a "scheme" that

(2) The exit report must be filed with the Commission in electronic format through EDGAR in accordance with EDGAR rules set forth in Regulation S-T.

(g) Transition Period for Trading Platforms. No trading platform shall be subject to the requirements of Section 6 of the Exchange Act due to activity related to the trading of Tokens subject to a determination pursuant to paragraph (f)(iii) of this section, provided that the trading platform prohibits such trading within six months of such determination.

(h) Tokens Previously Sold. An initial development team that prior to the effective date of this rule sold Tokens pursuant to a valid exemption from registration or sold in violation of Section 5 of the Securities Act of 1933 as determined in a Commission order pursuant to Section 8A of the Securities Act of 1933 that does not identify any other violations of the federal securities laws may rely on this section if the conditions of paragraph (a) are satisfied. The notice of reliance required by paragraph (c) of this section must be filed as soon as practicable.

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

(j) Disqualifications. No exemption under this section is available for the Tokens of any initial development team if it or its individual members would be subject to disqualification under Rule 506(d).

(k) Definitions.

(1) *initial development team*. Any person, group of persons acting in concert, or entity that provides the essential entrepreneurial and managerial efforts for the development of the Autonomous System prior to reaching Token Maturity and makes the initial filing of a notice of reliance on this safe harbor.

(2) *Token Maturity*. Token Maturity may be achieved for a Token in either of the following ways:

(i) The value of the Token primarily correlates to or depends on the usage or adoption of an Autonomous System that is governed by and/or integrally uses the Token for its operation or security, where "Autonomous System" refers to a Blockchain System that is

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constitutes an investment contract, but are not necessarily individual securities. The current registration forms and rules are not geared toward registration of an investment contract scheme, but rather to registration of individual express securities. In general, the Howey test is really geared toward rescission remedies rather than identifying registrable securities, and thus when the safe harbor fails to be completed, perhaps a rescission remedy or a managed process of 'unwinding' of the securities scheme may be more appropriate than a registration-based solution. This, however, raises many legal and policy issues, so we have chosen not to grapple with it in this proposal.

not economically or operationally controlled and is not reasonably likely to be economically or operationally controlled or unilaterally changed by any single person, entity, or group of persons or entities under common control, except that Autonomous Systems for which the initial development team owns more than 20% of Tokens or owns more than 20% of the means of determining Autonomous System consensus or governance cannot satisfy this condition. The definition is not meant to preclude Autonomous System alterations achieved through a predetermined procedure in the source code that uses a consensus mechanism among all or a subset of Autonomous System participants (which may include voting power associated with the Tokens). Notwithstanding the foregoing, "layer-2" Blockchain Systems that are verifiable with reference to the data stored on, provide a guaranteed power of exit to, and are susceptible of forced-transaction-inclusion from, a "layer-1" Blockchain System satisfying the test for 'Autonomous System' set forth in the preceding part of this clause '(i)', shall also be deemed Autonomous Systems and may create a basis for the Token Maturity of a Token the value of which primarily correlates to or depends on the usage or adoption of such "layer-2" Blockchain System or any additional Blockchain System deployed thereon, provided that the maximum ownership threshold summarized above and the other relevant conditions for obtaining Token Maturity in connection with an Autonomous System set forth in this Rule 195 are satisfied.

or

(ii) The value of the Token primarily arises from or correlates to or depends on the usage or adoption of a Qualifying Consumer Application and the Token's usage or functionality in connection therewith, as demonstrated by the holders' use of Tokens for the transmission and storage of value within the Qualifying Consumer Application, the participation in the Qualifying Consumer Application, or otherwise in a manner consistent with the utility of the Qualifying Consumer Application. "Qualifying Consumer Application" means a software application or other product or service which relies in whole or in part for its end-user licensing, end-user access, pricing, distribution, or functionality on the usage of a Token as an application access credential, an in-application virtual currency or a points, discount, rebate or credit accrual measure, or similar mechanism, and whose independent market value or pricing, if any, does not primarily arise from a correlation to the profits and losses of the application operator or developer from owning, running, or sponsoring the application or the other enterprises or businesses of the operator or developer.

(3) Qualifying Transaction. Qualifying Transaction means any offer, sale, or transaction forming a part of or pursuant to:

(i) the public distribution or allocation of Tokens, in one or a series of transactions,:

(A) (i) in exchange for or recognition of or incentive for or facilitation of past or future usage of such Autonomous System or Qualifying Consumer Application; or (ii) as a reward or incentive for conducting activities primarily related to operating, governing or securing the related Autonomous System, such as mining, validating, staking, performing system liquidations, storing or publishing data, or maintaining the availability of decentralized interfaces for or tools for facilitating usage of the Autonomous System; or

(B) to any governance system for the related Autonomous System that is controlled primarily by holders of the Tokens or other users of the Autonomous System[38]; or

(ii) the private distribution or allocation of any Tokens, in one or a series of transactions, to members of the initial development team or to other persons primarily as a reward or incentive for researching, developing, promoting, marketing, educating, providing professional services with respect to, or coordinating offchain activities with respect to, the related Autonomous System or Qualifying Consumer Application;[39]

(iii) any offer or sale of the Tokens on an open secondary market, where there is no agreement between the purchaser and the seller for the seller to pool the proceeds of sale of the Tokens for use as risk capital for entrepreneurial efforts benefitting the purchaser;[40] or

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[38] Intended to cover DAO smart contracts or token-governed legal entities through which issued/outstanding governance tokens vote on the use of unissued/treasury governance tokens.

[39] This reflects the holding on service provider token incentives in SEC v. Ripple.

> Moreover, from a policy perspective, exempting 'team token rewards' makes sense. Initial development teams for Blockchain Systems tend to be relatively small & intimate. People who work on these systems will be very well informed about, and have a material role in shaping, the risks and benefits of the Tokens and the related Blockchain Systems and applications. The team can be seen as more of a partnership (which, under Williamson and other cases, creates a presumption of non-securities status) for the creation of the token. From a policy perspective, this is very different from large corporate enterprises like pre-IPO Google that the SEC has historically focused its securities-incentive-compensation policy and enforcement actions around and where employees may be in a position more similar to outside investors and have an important interest in receiving information such as detailed financial statements of their employer.

[40] This reflects the holding on "programmatic sales" in *SEC v. Ripple.* We are aware of other proposals (which we generally consider thoughtful) that seek to exclude initial development team and/or early private investors from sales of tokens into the secondary market, until the point when Token Maturity is achieved. While we understand are sympathetic to many of the policy

(iv) any transaction that is otherwise exempt from the registration requirements of Section 5 of the Securities Act of 1933.

(4) *Related Person*. Related person means the initial development team, directors or advisors to the initial development team, and any immediate family member of such persons.

(5) "Blockchain" means a distributed data structure consisting of hashlinked sets ('blocks') of transactions.

(6) "Blockchain System" means either

(i) the combination of:

(A) a Blockchain; and

(B) a network of one or more devices operating software clients or software applications that jointly or individually store, validate, process transactions with respect to, update, resolve forks with respect to or otherwise maintain, validate, read from, store data with respect to, create; or

(ii) any executable bytecode (commonly known as 'smart contracts') deployed to a Blockchain System of the kind described in clause '(i)' above for operation by node operators running validators, sequencers or similar network operators on such Blockchain System.[41]

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concerns around this (early dumping of tokens onto 'retail' without having completed key work), there are counterpoints: (a) either the *Ripple* holding on programmatic sales is wrong, or such sales are allowed under current law—assuming the *Ripple* holding is wrong may be controversial; (b) one of the most deleterious features of current crypto market structure for 'retail' is the "low-float, high-FDV" phenomenon that is driven in part by long team/investor lockups and delayed public liquid market price discovery; (c) the free market can evolve lockup practices in various ways, for example by punishing the performance of early-dumped tokens or by VCs who wish to ensure the teams they invest build 'for the long haul' imposing contractual lockups on those teams when they invest; and (d) requiring achievement of Token Maturity before tokens can be sold by the team / investors into the secondary market on a programmatic basis will favor VC-backed teams that can raise through Reg D rounds to build a long-lasting warchest over "bootstrappy" teams that choose to run lean and wish to maximize distribution to "retail" in the public markets. All that being said, we could see potential merit to a mandatory lockup proposal if it is at least as permissive as existing exemptions around restricted securities that are not control securities (including ability to take advantage of a modified form of Rule 144, sales to Qualified Purchasers, sales to accredited investors, 4(a)(7), 4(a)(1)(1/2), etc.), but if such an approach is taken, it should also require public disclosure of the terms of the permitted private-market 'pre-unlock' secondary sales so that a "bullish unlock" phenomenon is possible and the current low-float/high-FDV adverse market structure may be corrected over time. (*See* Cobie, "On the meme of market caps & unlocks", https://cobie.substack.com/p/on-the-meme-of-market-caps-and-unlocks).

[41] The Safe Harbor 2.0 Proposal's language seemed predicated on talking about "networks" which basically seemed to be what we now commonly call "L1s". An L1 can be decentralized/autonomous, but so can a set of smart contracts built on top of the L1 (for example, a DeFi "protocol") or another, less decentralized blockchain that "borrows security" from the L2 (e.g., an L2, L3,ec.). It is very important that the term "Blockchain System" does not only encompass "networks" (of all kinds—L1s, L2s, L3s) but also smart contract systems built on top of those "networks".

(5) *Token*. A Token means any virtual currency, token, or other unit of account or medium of exchange that is implemented exclusively or primarily on a Blockchain System, regardless of whether transferable, non-transferable, fungible or non-fungible[42]

(6) "extrinsically affiliated" means, with respect to any two persons, any Blockchain System and any Tokens related to such Blockchain System, that: (a) due to arrangements or agreements outside of the Blockchain System (such as ownership of one person's equity securities by another or common ownership of a third person's equity securities), 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 management, operation, use or control of influence over the Blockchain System; or (b) such persons have agreed to act in concert for the purpose of acquiring, holding, voting, using or disposing of the Tokens or managing, operating, using or controlling or influencing the Blockchain System; provided, however, that two persons independently using or agreeing to use the Tokens for their intended purposes within the Blockchain System (such as by independently contracting with the initial development team to participate in a proof-of-stake consensus process that results in agreement among stakers or validators, or to regularly independently vote on Blockchain System governance proposals) shall not, in itself, constitute extrinsic affiliation.

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 marketplace 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.

[42] Note that this definition deliberately departs from the legally common but technologically unintelligible definition of a token as a 'representation of value'. Most tokens have value, but few 'represent value' as, unlike stock certificates etc., they are non-semiotic.

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 Investment Company Rule 3a-10. Exemption from investment company status for Autonomous Systems

Notwithstanding section 3(a) of the Act, an Autonomous System (as defined in Rule 195 of the Securities Act of 1933) will be deemed not to be an investment company.[43]

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.

[43] It's possible this may be more appropriate for a later DeFi-specific proposal, but decided to add it in here as a discussion point. It is needed because the SEC threatened to characterize many fully decentralized/autonomous DeFi systems (even governance-minimized ones) as investment companies. *See* e.g. "*Why did I quit in 2022*" -Andre Cronje, https://andrecronje.medium.com/why-did-i-quit-in-2022-e9a3a6ae91ef On the other hand, we understand that facts/circumstances like the original TheDAO likely should be considered investment companies if not otherwise exempt (especially if they invest in securities) and do not intend to exclude those.