Security Token Offering
Case Study
Part Two

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FinTech4Good aims to provide business leaders with the most up to date blockchain business insights through our Weekly Briefing. We will feature some of the most exciting projects and influencers in the space.

——Xiaochen Zhang
President of FinTech4Good

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The ICO market is cooling down. According to the latest statistics, no more than 353 million capital raised through ICO in November, 2018. At the same time, more and more start-up companies switch to STO to raise fund for their future development. Based on the FinTech4Good database, 80 STOs issued since 2017, among which 77.5% happened in the U.S.

In the U.S., an issuer of a security token must register the offer and sale of the security tokens with the Securities Exchange Commission (SEC) unless a valid exemption to registration applies. The purpose of this report is to give companies aimed to launch STO in the United States a solid guidance regarding the SEC exemptions from initial public offering, as well as the analysis on existing companies adopted those exemptions.

Among all ongoing or completed STO in the U.S., we selected one typical example for each exemption to analyze. The cases are not selected based on the business models or financial performances. In this Part II report, we will discuss two cases for Regulation D STO and Regulation S STO. Please well noted that nothing published in this report should be regarded as investment advice or an endorsement for any project.
Preface

Regulation A+ Offering (Part I)

Regulation CF Offering (Part I)

Regulation D Offering (Part II)

Regulation S Offering (Part II)

Summary & Conclusion (Part II)
Regulation D Offering

Official Guide:

Under the federal securities laws, any offer or sale of a security must either be registered with the SEC or meet an exemption. Regulation D under the Securities Act provides a number of exemptions from the registration requirements, allowing some companies to offer and sell their securities without having to register the offering with the SEC.

Companies that comply with the requirements of Regulation D do not have to register their offering of securities with the SEC, but they must file what’s known as a "Form D" electronically with the SEC after they first sell their securities.

Source: https://www.investor.gov/additional-resources/general-resources/glossary/regulation-d-offerings
Companies target to a unlimited capital raise.

The main investors of the companies are financial institutions or high-net-wealth individuals.

Companies have relatively small budgets for the issuance cost and marketing fees.

### Issuers of Regulation D Offerings are:

<table>
<thead>
<tr>
<th>Maximum Offering</th>
<th>Rule 504</th>
<th>Rule 506(b)</th>
<th>Rule 506(c )</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form Need to File</td>
<td>Form D</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notice Required to SEC</td>
<td>Within 15 days after the first sale</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Limits on Unaccredited Buyers</td>
<td>No limit</td>
<td>Up to 35 investors, who must be sophisticated</td>
<td>Accredited investors only</td>
</tr>
<tr>
<td>Limits on Accredited Buyers</td>
<td>No limit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Advertising</td>
<td>General prohibition</td>
<td>General Prohibition</td>
<td>Allow for exceptions</td>
</tr>
<tr>
<td>Financial Disclosure</td>
<td>No specific requirements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Holding Period Before Resale</td>
<td>Restricted (1 year in general)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intermediary</td>
<td>No specific requirements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subject to Blue Sky Laws</td>
<td>Partly subject to or state exemption</td>
<td>No subject to</td>
<td></td>
</tr>
</tbody>
</table>

* An individual “accredited investor” should have:
  - A minimum of $200,000 in earned income ($300,000 when combined with a spouse) in each of the two prior years and a “reasonable expectation” of a repeat in the current year, or
  - $1 million or more in net worth, not including primary residence.

* An “accredited investor” may also be an entity such as a bank, partnership, corporation, nonprofit or trust, when the entity satisfies certain criteria.
Preparation:

• Organize a team with security attorneys, accountants, broker-dealers, consultants and market advisors.

• Prepared documents including Private Placement Memorandum (PPM), subscription agreement, etc.

Issuance:

Announced the selling period of the offering.

Conduct KYC/AML process to verify the accreditors investors, sophisticated investors and unsophisticated investors.

Distribute security tokens to the subscribers.

Filing:

A regulation D offering commenter is required to file Form D with SEC within 15 days after the first sale of securities in the offering.

Trading:

The security tokens issued under Regulation D are restricted securities which can only be traded to non-accredited investors on designated platform 1 year after the close of the offering.
Regulation D Offering (Rule 506 (c))

Case Study: tZERO Group, Inc

Company Introduction

tZERO Group, Inc. (“tZERO“) is a majority owned subsidiary of Overstock.com, focusing on the development and commercialization of financial technology (FinTech) based on cryptographically-secured, decentralized ledgers – more commonly known as blockchain technologies. tZREO builds an exchange platform that seeks to offer traders access to the security token secondary market by providing encrypted accounts, a trading venue and clearing settlement services. Since its inception, tZERO has pioneered the effort to bring greater efficiency and transparency to capital markets through the integration of blockchain technology.

tZERO Regulation D STO

Basic Information:
Token: ERC-20 compliant token
Type: Preferred Equity Tokens (no voting right)
Token Supply: 26,228,771
Average Token Price: $5.14
Total amount raised: $134,794,328
Distribution Date: October 12th
Holders: 1079 addresses
STO Period: 2017/12/18-2018/08/06
Payment accepted: USD, BTC or ETH valued in USD

STO Service Providers
(i) Broker-dealer
Americas Executions, LLC
Fusion Analytics Securities, LLC
Chardan Capital Markets, LLC
(ii) Issuance Platform
SAFTLaunch
StartEngine Crowdfunding
(iii) Advisor
Alchemist Group LLC
Liquid Digital Holdings LLC
Distributed Network Advisors LLC
Others Marketing Advisors (Not disclosed)

STO Service Expenses:
Sales Commission Fee: $1,924,027
Advisory and Other Service Fees: Customary fees not disclosed
* Expected 2.3 million tokens as compensation for advisory

Source: https://www.sec.gov/Archives/edgar/data/1130713/000110465918013731/a18-7242_1ex99d1.htm
https://www.sec.gov/cgi-bin/browse-edgar?company=T0&owner=exclude&action=getcompany

Capital Raised in combined Reg D & Reg S STO: 134 Millions

Offshore investors 15%
U.S. Investors 85%
tZERO announced STO pre-sale, utilizing a Simple Agreement for Future Tokens. The company began sending offering memorandum to accredited investors.

SEC conducted investigation on STO and requested that the company voluntarily provide certain documents.

tZERO released an Amended, Supplemented and Restated Private Placement Memorandum. Besides, considering the huge interested attracted, tZERO switched the issuance platform from SaftLaunch to StartEngine for the subsequent sales period.

tZERO completed the issuance of preferred Tzero security tokens. The tokens will be locked up in the custodial wallet until January 10, 2019 (90 days after issuance).

tZERO announced the close of STO, ending with a capital raise of $134 million, much less than the targeted 250 million dollars.

tZERO signed Letter of Intent with GSR Capital for Security Token Investment. Security Token Offering closing date extended to August 6, 2018 to accommodate GSR and other investors.
Regulation D Offering Case Study

tZERO Group, Inc.

Case Analysis (I):

- **Background Information — STO issuance under Regulation D & Regulation S**
  Targeting a capital raise over $50 million, tZERO announced its token offering in December 2017. Rather than going through the long preparation and reviewing period of public offering, tZERO utilized the private placement to satisfy the funding need. Regarded as one of the pioneers of the blockchain industry, tZERO is the investment target of many financial funds and high-net-worth individuals. It was not surprising that tZERO’s STO made a big splash in the market and attracted $100 million investment committed within half day since the announcement.

- **Extended offering period — Global Strategic Investors**
  Originally, tZERO was expected to close the STO by May 2018. To get more involvement from international strategic investors, tZERO extended the closing date of STO to August 6, 2018. GSR Capital, one of the leading venture capitals in Hong Kong, revealed that it signed the purchase agreement for $30 million tZERO Security Tokens from Overstock. Approximately 1,000 people from 30 countries participated in tZERO’s STO, making it one of the most widely held security token globally.

- **Liquidity — Secondary Trading**
  The tZERO security tokens will be traded on tZERO security token exchange or other designated exchanges after the lock-up period. In partnerships with strong partners and strategic investors, tZERO is expected to enjoy a promising future, which can be considered as an exciting news toward tZERO preferred security tokens.
Regulation D Offering Case Study

tZERO Group, Inc.

Case Analysis (II):

- **Legal issues — SEC investigation**
  
  According to the Wall Street Journal, the SEC has issued dozens of subpoenas and information requests to technology companies and advisors in the market regarding to ICO. Disclosed in Overstock’s 8-K filing, the SEC probed tZERO’s token offering since February, and requested tZERO and Overstock to voluntarily provide certain documents. Nevertheless, tZERO claimed that the investigation did not mean that the SEC had concluded that anyone has violated the law, or had a negative opinion of any person, entity, or security. While the stock price of Overstock dropped by 10% after the disclosure of the investigation.

  Besides, the latest Form D filed by tZERO showed that the number of investors under Regulation D offering decreased by approximately 9% since the end of February, 2018.

- **Learning points — impacts for future Regulation D STO**
  
  Considering the high risk of ICO projects, investors become cautious when evaluating token-related investments. With compliance management built-in, tZERO attracted global investors to successfully raise capital for future development. The combination of Regulation D and Regulation S prove it’s executable way to raise large capital internationally. However, even though tZERO raised significant amount of capital from investors coming from 33 different countries, the raised capital is still far from their target. The fact that investors withdrew their investments and the extension of capital raising campaign show that people still remain doubtful regarding the STO, an innovative way to fund raising. Regardless of people’s doubts, capital raising through STO for companies like tZERO which has descent technical background and real applications will become a major trend.
Regulation S Offering

Official Guide:

Regulation S is a "safe harbor" that defines when an offering of securities is deemed to be executed in another country and therefore not be subject to the registration requirement under section 5 of the 1933 Act. The regulation includes two safe harbor provisions: an issuer safe harbor and a resale safe harbor. In each case, the regulation demands that offers and sales of the securities be made outside the United States and that no offering participant (which includes the issuer, the banks assisting with the offer and their respective affiliates) engage in "directed selling efforts". In the case of issuers for whose securities there is substantial U.S. market interest, the regulation also requires that no offers and sales be made to U.S. persons (including U.S. persons physically located outside the United States).

Source: https://en.wikipedia.org/wiki/Securities_Act_of_1933#Regulation_S
Regulation S Offering

Offshore Offers and Sales

**Provisions**
- Rule 901—General Statement
- Rule 902—Definitions
- Rule 903—Offers or Sales of Securities by the Issuer;
- Conditions Relating to Specific Securities
- Rule 904—Offshore Resale
- Rule 905—Resales Limitations

**Investment Limitation**
- Non-US investors only
- Offers and sales outside the U.S. only

**General Solicitation**
No offering participant is allowed to engage in "directed selling efforts".

Regulation S transactions will be reported within 15 days on Forms 10-Q, 10-QSB, 10-K or 10-KSB, as applicable.

**Resales Restriction**
Regulation S does not provide a safe harbor for resales of securities into the United States, and any resales must be made pursuant to a registration statement or an exemption from the Securities Act.
Regulation S Offering
Process and Timeline

Preparation:
Assemble a team with legal attorney, underwriter, transfer agent, and other service providers to prepare offering memorandum, notice of restriction and other documents.

Issuance:
- Conduct market campaign to promote the offering outside the U.S.
- Take KYC/AML check to verify eligible investors
- Distributed security tokens to the subscribers.

Filing:
File forms (10-Q, 10-K, 10-QSB, 10-KSB) with SEC if applicable.

Trading:
The security tokens issued under Regulation S can only be traded offshore between non-US investors after the close of the offering.

* A Regulation S Offering could be combined with a registered public offering in the United States or an offering exempt from registration in the United State.
Regulation S Offering
Case Study of SPiCE VC

Company Introduction

SPiCE VC aims to disrupt the venture capital industry using blockchain technology.

The company aims to solve a crucial problem in the venture capital world: the 7 to 10 years liquidity period. They aim to “bridge the gap” between angel investors and series A funding rounds – which is a gap many startups struggle to cross.

SPiCE announced the launch of their STO at October, 2017. That STO is for their VC fund. The VC fund can accept investments from pre-qualified investors (based on country-specific regulations) while offering immediate liquidity in a market that, up to this point, has been completely illiquid.

Source: https://bitcoinexchangeguide.com/spice-vc/
Regulation CF Offering
Case Study of SPiCE VC

**Basic Information:**

Country of origin: Singapore
Token Supply: 130,000,000 SPiCE Tokens
Target Fund Size: USD 10,000,000
Offering price: 1 USD
Token Type: ERC-20 compliant token
Currencies accepted: USD, EUR, ETH and BTC
Investors: (i) up to 99 beneficial owners under Reg D (ii) unlimited subscribers under Reg S
Token holder right: Profit Share Right, no voting right, no dividend right
Term of token: SPiCE VC has a fixed termination date of 7 years from the date of the closing of the Offering, which can be extended by a further 2 years, if determined.

*STO service providers and corresponding costs: Not disclosed*
The disruption in the VC market
Originally from Singapore, SPiCE VC issued STO complied with Regulation D and Regulation S to attract global investors to invest the blockchain-based venture capital fund, which is considered as a disruption in the venture capital market. According to the terms of the offering, only up to 99 investors under Regulation D can subscribe to the offering, implying that the offering is mainly focus on investment outside the U.S.. Comparing with the traditional venture capitals, the tokenized SPiCE VC fund gives the investor a new way to redeem their investment at a earlier time point, shortening the term of the VC investments, which significantly improve the liquidity of VC investments, making SPiCE tokens more popular among investors.

SPiCE VC financial datas
The token is priced at the NAV of the venture fund, and the corresponding NAV report will be disclosed by SPiCE VC on a quarterly basis. As of September 30, 2018, the NAV report for Q3/2018 showed the NAV of 1.37 per token and the net asset under management equaled $15,247,743. Based on the performance of recent half year, SPiCE VC has achieved great income for the token holders, regarded as a pioneer and leader in the market.

Trading Compliance
SPiCE VC announced on November 18, 2018 that its security token will trade on the OpenFinance Network, allowing non-US investors to trade their tokens from the day. However, due to the restriction of Regulation D, US accredited investors have to wait until March of 2019 to unlock the liquidity of their tokens.

First Token in Circulation
SPiCE Tokens are allowed to trade among non-American investors since November 2018 via OpenFinance Network. It marks the first asset of its kind to list on a US regulated trading platform. The emergence of the first ST circulation case is of positive significance to other existing and potential projects. As for other existing projects, SPiCE VC’s experience can be used as a reference for currency trading on a suitable exchange platform. In terms of potential projects, issuers have found a shining selling point to attract potential investors to invest in the bear market. Circulation is no longer daydream, but a real path.
Summary and Conclusion
Take-away

To wrap-up the regulations of four exemptions under SEC IPO in the U.S., we brief summarized below:

• **Regulation A**: Reg A+ is an alternative to a traditional IPO, which makes it easier for smaller, early stage companies to access capital. We suggest companies who want to offer shares to the general public with relative high offering amounts to choose Reg A+.

• **Regulation D**: Reg D is the most common method that startups use to raise money from investors without being required to register with the SEC. Rule 506(b) and 506(c) allow issuers raise unlimited capital. However, Reg D has strict restrictions on accreditation of Investors and holding period before resale.

• **Regulation Crowdfunding**: Startups who want to raise small amounts of money from general public including non-accredited investors can choose this regulation. It takes less time and money than other exemptions.

• **Regulation S**: If offers and sales of securities tokens are outside the United States, Reg S is available. A company that makes their offering under Reg S is also allowed to use other regulation exemptions to raise capital in the U.S.
## Summary of Exemption Offerings

<table>
<thead>
<tr>
<th></th>
<th>Public Offering Exemption: Reg A+</th>
<th>Private Offering Exemptions: Reg D</th>
<th>Reg CF</th>
<th>Reg S</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Maximum Offerings</strong></td>
<td>$20 Million</td>
<td>$5 Million</td>
<td>No Limit</td>
<td>$1,070,000</td>
</tr>
<tr>
<td><strong>Cost of Issuance</strong></td>
<td>High</td>
<td>Median</td>
<td>Low</td>
<td>Fees may include: Audit Fees, Legal Fees, State Filing Fees, Financial Intermediary Fees, Market Fees</td>
</tr>
<tr>
<td></td>
<td>Fees may include: Audit Fees, Legal Fees, State Filing Fees, Financial Intermediary Fees, Market Fees</td>
<td>Fees may include: Financial Intermediary Fees, Legal Fees, Accreditation Verification Fees, AML Fees, Market Fees</td>
<td>Fees may include: Audit Fees, Online Intermediary Fees</td>
<td></td>
</tr>
<tr>
<td><strong>Time of Issuance</strong></td>
<td>More than 120 Days</td>
<td>30 ~ 60 Days</td>
<td>30 ~ 50 Days</td>
<td>40 ~ 90 Days</td>
</tr>
<tr>
<td><strong>Limits on accreditation of Investors</strong></td>
<td>No Limit</td>
<td>No Limit</td>
<td>Up to 35 unaccredited investors, who must be sophisticated</td>
<td>Accredited Investors Only</td>
</tr>
<tr>
<td><strong>General Advertising</strong></td>
<td>No Prohibition</td>
<td>General Prohibition</td>
<td>No Prohibition</td>
<td>Can't advertise the terms of the offering except in a notice that directs investors to the intermediary's platform</td>
</tr>
<tr>
<td><strong>Liquidity</strong></td>
<td>High</td>
<td>Median</td>
<td>Low</td>
<td>1. Can't be resold in United States 2. No requirements on holding period before resale</td>
</tr>
<tr>
<td></td>
<td>1. No requirements on holding period before resale 2. Limitations on resale amounts in the first year 3. Require a registered transfer agent for Tier 2</td>
<td>Generally cannot be resold for a period of 6 months or one year</td>
<td>Generally cannot be resold for a period of one year</td>
<td></td>
</tr>
</tbody>
</table>

Source: FinTech4Good
FinTech4Good (FT4G) is a global network which connects start-ups, investors, industry leaders and public sectors to introduce impactful fintech and blockchain solutions to frontier markets through incubation, acceleration and investment.