

## Public Statement

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# Token Safe Harbor Proposal 2.0



**Commissioner Hester M. Peirce**

**April 13, 2021**

Earlier today, I released on GitHub<sup>[1],[2]</sup> an updated version of the token safe harbor proposal that I originally suggested in February 2020.<sup>[3]</sup> The safe harbor seeks to provide network developers with a three-year grace period within which, under certain conditions, they can facilitate participation in and the development of a functional or decentralized network, exempted from the registration provisions of the federal securities laws. The updated version reflects constructive feedback provided by the crypto community, securities lawyers, and members of the public. I am grateful for the thoughtful engagement and believe it demonstrates the need for regulatory clarity in this space. There is, however, more work to be done, which is why I, as a believer in the value of drawing on decentralized knowledge, posted the safe harbor on GitHub.

Three significant changes mark the updated version. First, to enhance token purchaser protections, the safe harbor proposal now requires semi-annual updates to the plan of development disclosure and a block explorer. Second, in response to concerns about the lack of clarity at what happens at the end of the three-year grace period, the safe harbor proposal now includes an exit report requirement. The exit report would include either an analysis by outside counsel explaining why the network is decentralized or functional, or an announcement that the tokens will be registered under the Securities Exchange Act of 1934. Third, the exit report requirement provides guidance on what outside counsel's analysis should address when explaining why the network is decentralized. The guidance is not a bright-line test, but rather attempts to strike a balance between providing a manageable number of useful guideposts while maintaining sufficient flexibility for the facts and circumstances of each network to be considered in the analysis.

Now, as a new Chairman is coming into the SEC with a new agenda, is the perfect time for the Commission to consider afresh how our rules can be modified to accommodate this new technology in a responsible manner. I invite the public to provide feedback on the updated proposal and look forward to the continued honest and open debate on how to address the issue.<sup>[4]</sup>

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## Appendix

### Proposed Safe Harbor – Time-limited Exemption for Tokens.

*This potential safe harbor is not a rule, regulation, or statement of the Securities and Exchange Commission. It cannot be relied on. It does not necessarily reflect the views of the Securities and Exchange Commission or my fellow Commissioners.*

### Proposed Securities Act Rule 195. Time-limited exemption for Tokens.

### ***Preliminary Notes:***

*1. The analysis of whether a digital asset is offered or sold as a security is not static and does not strictly inhere to the digital asset. A Token may be offered and sold initially as a security because it is wrapped in a transaction involving an investment contract, but the Token may later be offered and sold outside of an investment contract. For example, sales of a particular Token likely would not constitute sales of an investment contract if purchasers could no longer reasonably expect a person or group to carry out the essential managerial or entrepreneurial efforts.*

*However, for a network to mature into a functional or decentralized network that is not dependent upon a single person or group to carry out the essential managerial or entrepreneurial efforts, the Tokens must be distributed to and freely tradeable by potential users, programmers, and participants in the network. The application of the federal securities laws to the primary distribution of Tokens and secondary transactions frustrates the network's ability to achieve maturity and prevents Tokens sold as a security from functioning as non-securities on the network.*

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

*By the conclusion of the three-year period, the Initial Development Team must determine whether Token transactions involve the offer or sale of a security. Token transactions may not constitute securities transactions if the network has matured to a functioning or decentralized network. The definition of Network Maturity is intended to provide clarity as to when a Token transaction should no longer be considered a security transaction but the analysis with respect to any particular network will require an evaluation of the particular facts and circumstances.*

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

**(a) Exemption.** Except as expressly provided in paragraph (d) of this section, the Securities Act of 1933 does not apply to any offer, sale, or transaction involving a Token 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 within three years of the date of the first sale of Tokens;
- (2) Disclosures required under paragraph (b) of this section must be made available on a freely accessible public website.
- (3) The Token must be offered and sold for the purpose of facilitating access to, participation on, or the development of the network.
- (4) The Initial Development Team files a notice of reliance in accordance with paragraph (c) of this section.
- (5) 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.** A text listing of commands to be compiled or assembled into an executable computer program used by network participants to access the network, amend the code, and confirm transactions.

(ii) *Transaction History*. A narrative description of the steps necessary to independently access, search, and verify the transaction history of the network.

(iii) *Token Economics*. A narrative description of the purpose of the network, the protocol, and its operation. 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, the process for validating transactions, and the consensus mechanism;

(C) An explanation of governance mechanisms for implementing changes to the protocol; and

(D) 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) A hyperlink to a block explorer.

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

(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;

(B) The number of Tokens or rights to Tokens owned by each member of the Initial Development Team and a description of any limitations or restrictions on the transferability of Tokens held by such persons; and

(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.

(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.

(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 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) If Network Maturity has been reached for a decentralized network, an analysis by outside counsel 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 participation. If applicable, the description should include:

- (1) Examples of material engagement on network 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 Initial Development Team's pre-Network Maturity activities are distinguishable from their ongoing involvement with the network. The explanation should:

- (1) Discuss the extent to which the Initial Development Team's continuing activities 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 that is not publicly available; and
- (3) Describe the steps taken to communicate to the network the nature and scope of the Initial Development Team's continuing activities.

(ii) If Network Maturity has been reached for a functional network, an analysis by outside counsel must be provided. The analysis should:

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

(iii) If the Initial Development Team determines that Network 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) 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 as a class of securities within 120 days of the filing of the exit report.

(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, or entity that provides the essential managerial efforts for the development of the network prior to reaching Network Maturity and makes the initial filing of a notice of reliance on this safe harbor.

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

(i) 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 networks for which the Initial Development Team owns more than 20% of Tokens or owns more than 20% of the means of determining network consensus cannot satisfy this condition; or

(ii) Functional, as demonstrated by the holders’ use of Tokens for the transmission and storage of value on the network, the participation in an application running on the network, or otherwise in a manner consistent with the utility of the network.

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

(3) *Related Person.* Related person means the Initial Development Team, directors or advisors to the Initial Development Team, and any immediately family member of such persons.

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

(i) that has a transaction history that:

(A) is recorded on a distributed ledger, blockchain, or other digital data structure;

(B) has transactions confirmed through an independently verifiable process; and

(C) 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.

## 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 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.

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[1] The views I express are my own and do not necessarily represent those of the Securities and Exchange Commission or my fellow Commissioners.

[2] <https://github.com/CommissionerPeirce/SafeHarbor2.0>.

[3] Hester Peirce, Commissioner, SEC, Running on Empty: A Proposal to Fill the Gap Between Regulation and Decentralization (Feb. 6, 2020), <https://www.sec.gov/news/speech/peirce-remarks-blockress-2020-02-06>.

[4] Please feel free to make modifications on GitHub or send me your feedback at [CommissionerPeirce@sec.gov](mailto:CommissionerPeirce@sec.gov).