

# Regulations Overview of Initial Coin Offerings in the U.S.

This article provides a brief overview of the relevant ICO exemptions from certain provisions of the US federal securities law.

Despite all the lucrative opportunities presented to businesses in the Russian Federation, certain limitations, however, prevent it from being an ideal jurisdiction for conducting a safe and regulated initial coin offering (“ICO”).

In recent years the US market has seen countless successful ICO’s, with the Securities and Exchange Commission (“SEC”) monitoring each public coin offering closely for compliance with federal securities laws and pursuing the interests of the investors. This is a result of security tokens, as opposed to utility tokens, [being viewed by the SEC](#) as securities, and thus, regulated as such.

The difference between security tokens and utility tokens stems from their economic value: utility tokens only exist and can be used within a limited functioning network to purchase services or products. Security tokens, on the other hand, are a tradable digital asset, the economic value of which is tied directly to the issuing company and which the investors purchase expecting to gain profit.

The SEC uses the so-called Howey test in order to determine whether a specific token has all the characteristics of a security and requires regulation. Thus, a token is legally treated as a security if it meets the following criteria: (i) the investment involves money; (ii) the investor expects profits from his investment; (iii) the investment of money is in a common enterprise; (iv) profits are generated from efforts of a promoter or third party (SEC v. Howey, 328 U.S. 293 (1946)).

In general, if an ICO of a security token is targeted at American investors, such offering must be registered with the SEC, but this is not always the case. Certain SEC Regulations allow businesses to offer their coins with certain regulatory exemptions both privately and publicly. Below is a brief outline of the applicable Regulations.

## Regulation D

According to Rule 506 of Regulation D, it governs private coin offerings and exempts the issuing businesses from registering the token with the SEC. The issuing business can raise an unlimited amount of capital, however, the tokens can only be offered, promoted and sold to accredited investors or sophisticated investors (sophisticated investors are defined under Regulation D as persons who possess sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment). Under SEC Rule 501, the following are considered accredited investors:

- Persons earning at least \$200,000 per year or \$300,000 jointly with a spouse;
- Persons or married couples with a net worth exceeding \$1 million (excluding the value of their primary residence);
- Directors, executive officers, and general partners of the company issuing securities;
- Banks, insurance companies, investment companies, business development companies; or
- Businesses or trusts with over \$5 million worth of assets.

Regulation D requires much less paperwork than Regulation A+ and Regulation CF, but the issuing business is still required to: (i) file a Form D disclosure document (electronically) with the SEC, disclosing some basic information regarding the company and the offering; (ii) give disclosures to sophisticated investors, which usually include the offering memorandum and audited financial statements of the issuing company; (iii) answer any questions that the potential investors may have.

### **Regulation A+**

Regulation A+ governs public coin offerings and provides two tiers of offerings, which allow the issuing companies to raise up to \$50 million (with a minimum of \$2 million) in a 12-month period by selling tokens to both accredited and non-accredited investors, depending on the tier of offering. Under Regulation A+, the offering must be registered by filing a Form 1?A disclosure document with the SEC. In Tier 1 offerings the issuing business is required to provide additional information about sales and update the issuer information by filing a 1?Z Form with the SEC. Tier 2 offerings, on the other hand, require the issuing business to file audited financial statements in their offering documents and to file annual, semiannual, and current reports with the SEC on an ongoing basis.

### **Regulation CF**

Regulation CF, also referred to as CrowdFunding, governs exemptions for public coin offerings. Regulation CF allows the issuing companies to sell up to \$1,070,000 (one million seventy thousand dollars) in a 12-month period to both accredited and non-accredited investors. All transactions under Regulation CF must be effected through a SEC-registered intermediary and individual investors' investments are limited to a certain amount. The offering must be registered with the SEC by filing a Form C disclosure document, updates after selling 50% and 100% of the target offering amount, as well as annual Form C?AR reports.

Overall, the exemptions provided by the aforementioned Regulations allow all kinds of businesses to raise required capital for their pursued goals. In the second quarter of 2018 start-ups raised a cumulative amount of \$4.8 billion through ICOs in the USA. The most popular option seems to be Regulation D, as it was used by:

- Telegram (\$850 million);
- Filecoin (\$262 million);
- PolkaDot (\$144 million);
- Basis (\$125 million);

Please note that for each of the aforementioned Regulations the issuing company has to be incorporated and doing most of its business in the USA.

For more information please contact our Managing Partner [Andrei Danilov](#).

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