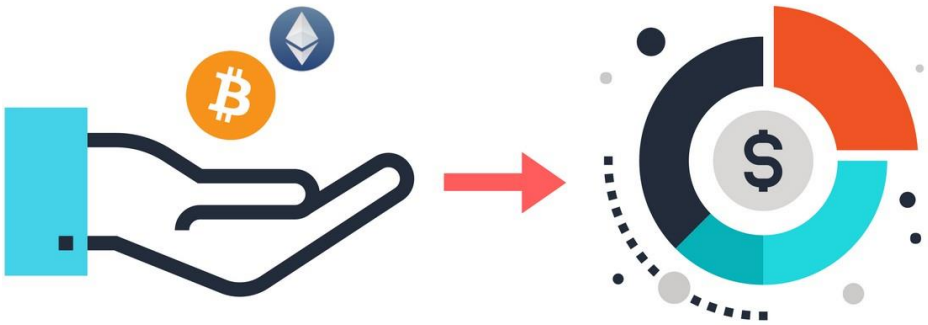

SEC SWEEP MIGHT HERALD PROGRESS IN THE ICO MARKET

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There was a lot of coverage of the SEC sweep on ICOs this morning, starting with the WSJ's article: "Cryptocurrency Firms Targeted in SEC Probe". This was followed by many others, including crypto-community coverage from CoinDesk. let's try to separate fact from fiction.

Most important, I do not believe that the SEC is taking issue with the concept of the SAFT (Sale of Future Tokens) per se, but rather with several specific issues that have become associated with the structure. The SAFT, like the SAFE (Sale of Future Equity) which spawned it, is a security, so the SEC already has jurisdiction over such offerings and have no problem with the form, if the sellers adhere to key principles of securities laws.

However, to my eyes, there have been many SAFT launches as well as public ICO issuance that potentially violate one of several important principles of securities laws. Since I am not an attorney, I will explain these principles in plain English:

- Tell the truth
- Don't make improper forward-looking statements

- Disclose conflicts of interest & special deals
- Disclose risks
- Disclose a reasonable basis for the value of the investment
- Don't make false promises of immediate liquidity (or tell investors that the tokens will be exempt from US Securities laws)

Notice that most of these are simple, common sense principles, which do not rely upon decades of legal precedents. That said, we have seen obvious violations of these principles from many ICOs and SAFT launches. Let's go through each:

Tell the truth: I do not want to single out individual ICOs that I believe to be guilty of this most basic principle, but the SEC enforcement division will certainly act. Lying as part of an investment solicitation is fraud, so there is no jurisdictional issue in prosecuting it, regardless of whether the token is judged a security.

Don't make improper forward-looking statements: The most obvious of improper forward-looking statements are investment guarantees, which SEC Chairman Clayton explained was a serious problem in his December 11th speech. Many ICOs, however, have been marketed with such language. It is important to remember that even if the whitepaper and "official" presentations are free from such claims, that social media posts or written research/articles created by compensated strategic advisers or board members must also avoid these statements. Once again, I am going to refrain from pointing fingers here, but I have seen many instances…

Disclose conflicts of interest & special deals: This category includes paying "advisers" or granting them tokens to "lend their name" or to promote the token sale without disclosure. Sadly, the practice of famous or influential people with virtually no interaction with the company, except to promote the offering, being compensated exclusively for their promotion, is widespread. Investors, meanwhile, believe that a project with such important advisers will likely succeed, and invest accordingly. It is interesting that it is probably true, to a point, as the advisers name recognition initially creates a self-fulfilling prophesy.

I have had personal experience with this phenomenon, as CoinRoutes is in the process of planning a compliant SAFT offering for our RouteCoin network. We have been approached by multiple people offering to find "advisers" that will promote our token, but, perhaps to our own detriment, have rejected the notion of paying for such a service.

Disclose a reasonable basis for the value of the investment: This one is tricky, since it involves a very specific problem with crypto-assets. With an equity security, if the company is successful, investors can rationally assume that such success will accrue benefits directly to the equity holders. There are some issues with voting rights, but equity holders generally participate proportionately in the success of the enterprise. With tokens, however, that is not necessarily the case. Consider Ripple, as an example. I am not saying that XRP token holders won't participate in the value of the Ripple network, but it is extremely unclear. Since token holders don't seem to have any profit participation in the network, and there is no cap on how many Ripple tokens are created, it is hard for me to understand the value proposition. Thus, even if Ripple replaces SWIFT as the dominant inter-bank network, it is hard to understand why XRP would have a lot of value. If, however, XRP has either a scarcity or intrinsic value that I am not understanding, it might be a good investment, but the point is that issuers should make this clear. This same issue pertains to many tokens, where the whitepaper describes an important use case for the network the token is a part of, but not a reason why the token itself will have value.

Disclose risks: This is the obvious flip side to the previous principle, but it can be of limited value as investors typically ignore such disclosures. I have seen ICO documents that, despite stating that the coin is likely worthless, still receive enormous sums of money. That said, it is an important rule, and is more important to be followed when affiliated people produce articles or promotional posts made in support of the ICO.

Don't make false promises of immediate liquidity (or tell investors that the tokens will be exempt from US Securities laws): This may be the rule the SEC is most concerned about. There are a lot of tokens that have been issued via a SAFT at first, only to follow with a public token issuance and arrangements to immediately trade on one or more of the crypto "exchanges." Personally, I think that this should be handled as part of SEC efforts to transform the secondary trading of crypto assets, but it is worth a quick comment. In my opinion, based on the DAO report and Chair Clayton's excellent synopsis that a token whose value is derived in a significant part from the "future entrepreneurial or managerial efforts of the founders" is a security, most ICOs are securities. The notion that some limited initial utility means that a token can trade freely on unregulated platforms due to that utility is nonsense. No one would pay hundreds of millions or billions of dollars for tokens that do almost nothing. The valuations of most of the large token offerings is based on the ability of the founding team to deliver value in the future. In that way, they are not different from other securities.

Taken as a whole, adherence to these principles could create a better market for both entrepreneurs and investors. Investors would gain improved understanding of what they are buying as well as defense against obvious fraud. Entrepreneurs, meanwhile, could finally gain some clarity about how to move forward. There is enormous potential, in my opinion, in the underlying technology, and that can be facilitated by the ability to attract investment dollars. In our case with RouteCoin, we believe that the concept of a self-regulating network to aggregate liquidity is only possible due to emerging blockchain technology, and I know of several other such examples personally. It is time for the SEC to start creating a US "rulebook" for issuers to follow so that we know how to proceed. I think that this enforcement sweep could provide an \ opportunity for them to do so.