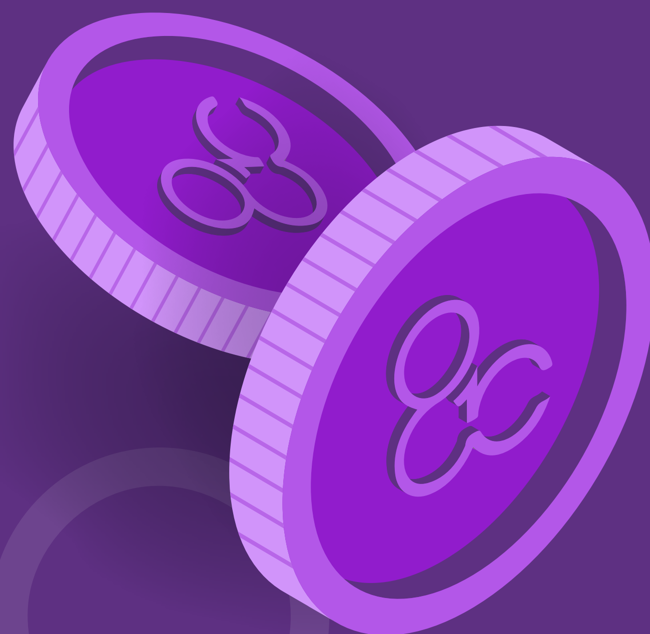
The Ultimate Guide to

Security Token Offerings



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Overview

Curious about investing in security tokens? Then this guide is for you.

Between 2017 and 2018, the blockchain and investment worlds were buzzing with news of initial coin offerings (ICOs), the new form of crypto-enabled fundraising that stood to change everything from how venture capital firms operate to how stock is bought and sold. It seemed like the hype would never end.

But reality caught up with ICOs when the U.S. Securities and Exchange Commission (SEC) answered the big question on everyone's mind: how will these new investments be regulated?

The SEC's 2017 ruling stated that the majority of ICOs were distributing unregistered securities, which meant they were fully responsible for following all applicable security regulations.

While the U.S. is not the only market for investments, it has influence over how other countries operate. Many other countries followed suit, ruling that ICOs were legal as long as they met strict securities regulations. Countries like China and South Korea, however, instituted outright bans on ICOs.

Paired with the "Wild West" nature of ICOs, these regulations caused the bubble to burst in 2018, and the hype began to die.

While some individuals criticized the SEC's ruling, many industry professionals viewed the stance as a major step forward because it provided a clear path for blockchain companies to follow.

With new regulatory clarity, the security token offering (STO) emerged as a new and improved form of ICO. Over the past few months, STOs have generated tremendous buzz as the future of ICOs, and many industry insiders hail them as the next big thing.

In this six-part series, we'll cover everything you need to know about STOs: what they are, how they work, what benefits they provide, and what the future holds for them.

If you'd like to jump ahead, use the navigation below.

Table of Contents

Chapter 1: Why Security Token Offerings Matter

Before you can understand STOs and where they fit into the investment world, it's important to understand why the industry needs them and how it stands to benefit.

IPOs and their blockchain-enabled counterpart, ICOs (which we'll cover in detail later) let outside investors participate in the financial success derived from entrepreneurship. The simple truth of the matter is that not all people are entrepreneurs. To bridge this gap, these investment vehicles give everyday people the opportunity to benefit from entrepreneurs by providing them with financial backing.

If you wanted to participate in the value created by entrepreneurship without being an entrepreneur yourself, you only had a few options available until recently: invest in a new company, become an accredited investor, or buy stock in a public company.

Who is an accredited investor?

Regulation D investments are generally only available to accredited investors. For most investors this means:

Net Worth **exceeds $1,000,000**
(**Not including** primary residence)

or

Income **exceeds $200K**
(Individual - each of last 2 years)

Income **exceeds $300K**
(Joint with spouse - each of last 2 years)

Back to Top ▲

Investors in newly launched businesses take partial ownership in the venture. Accredited investors (which the SEC defines as individuals who have an annual income of $200,000 or more, or a net worth of $1,000,000 or more) get to invest in a broad range of financial instruments that aren't available to others. And publicly traded companies have shares of their stock listed for sale on the world's exchanges. These are companies that have gone through the tedious and expensive initial public offering (IPO) process in pursuit of additional capital. They offer liquidity to early stage investors and give new investors the chance to participate in future success and growth.

The last of these generally sounds like the most viable option for outside investors to participate in entrepreneurship-powered value creation, but there are a number of shortcomings that tip the scale in favor of elite investors, making the system unfair to the average investor.

The problem with modern IPOs

The announcement of a new IPO for a trending company (think Facebook, Snapchat, and Twitter) often dominates financial market news, and with good reason: IPOs have been one of the most popular ways for companies to gain access to capital. Companies who file for IPOs have previously received backing from venture capitalists and angel investors, but believe going public will give them access to more money, a higher valuation, and more liquidity.

New IPOs are enticing because they will be publicly traded and (in theory) will allow anyone to have their share in the company's success buying purchasing shares on an exchange. But IPOs are not as inclusive as you may think.

A majority of IPO value is taken out before the option to purchase stock even reaches the hands of the average investor. In the investment rounds prior to a company's IPO, a number of banks, accredited investors, institutions, and high-net-worth individuals already taken their turn.

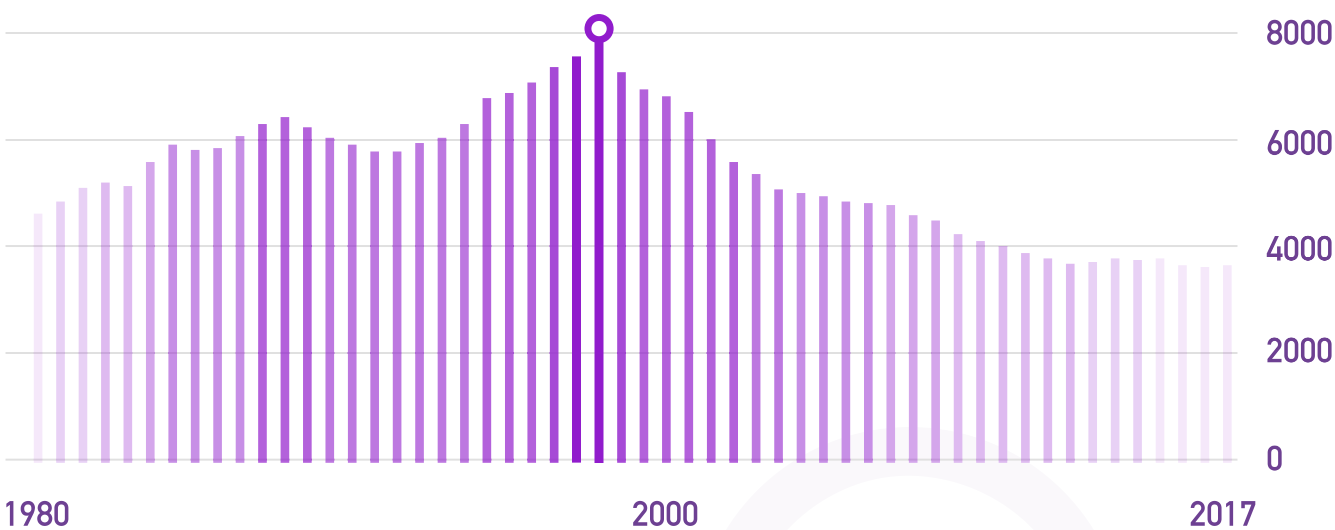
The early investing opportunities don't even stop there. Right before a company is about to file for IPO, there is a final round of "pirates" who take their piece directly from the retail public on the stock's way out the door. With big discounts on early buying opportunities, these guys reap huge profits on day one.

Back to Top ▲

This all happens before the public even gets a chance to invest. By the time they can, they are purchasing stock at inflated prices built on buzz and hype, not profit and cash flow.

Public companies often represent the Hollywood image of a successful Silicon Valley startup: the founders might have dropped out of Stanford, launched from their parents' garage, and become a unicorn business valued at $1 billion or more overnight. The problem is that these high-flying startups are rarely (if ever) actually generating actual profit, so their valuations are not based on hard financials. It all comes from growth and hype instead.

Where Have the Public Companies Gone?



Sources: Jay R. Ritter, Warrington College of Business Administration, University of Florida; University of Chicago Center for Research in Security Prices

Back to Top ▲

According to the Wall Street Journal, 3,700 companies went public in the United States in 2018, while the US Census Bureau reported that the country is home to more than 32 million businesses. This means that only 0.00001% of companies in the US are public. What about the other 31,996,300?

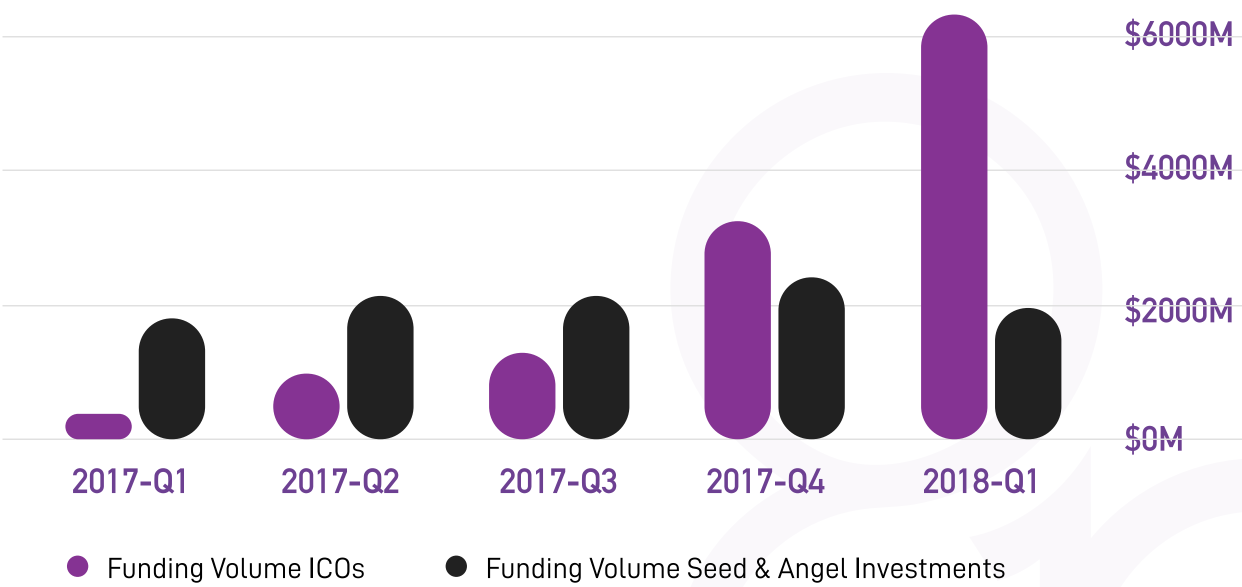
Even if they boast successful operations, stable cash flow, and profitability, the cost of going public in the modern IPO ecosystem is simply not feasible for them. This means the founders and early employees will never gain the benefits of being public. At the same time, investors will never gain the opportunity to invest in such emergent, cash flow positive businesses.

The problems facing both the average investor and average company within the current IPO ecosystem have led many people to the idea that the traditional system of investing and fundraising is broken. These problems have lead to the development of what we'll call "IPO 2.0" — initial coin offerings (ICOs) that aim to solve the problems within the modern IPO paradigm.

IPO 2.0: the rise of the ICO

ICOs were born from frustrations with the modern financial system and the emergence of blockchain technology. As a blockchain-powered fundraising mechanism, ICOs entered the scene in early 2017 and have raised over $13 billion in the short time since.

ICOs make it possible for anyone anywhere to invest in entrepreneurial ventures. The technology has also given founders the ability to raise money without relying on the usual financial and regulatory gatekeepers.

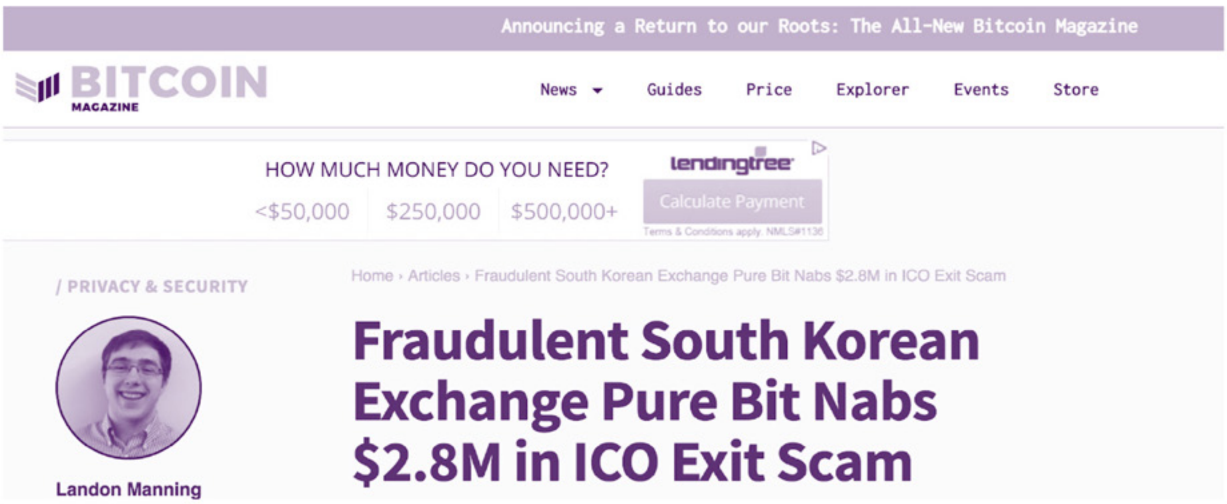


Back to Top ▲

In the first quarter of 2018 ICO funding exceeded VC funding, raising $6 billion against the conventional VCs' $2 billion. This much lesser-known investment vehicle that didn't even exist a decade ago outpaced an industry that's been around for over 60 years.

Although ICOs bring numerous benefits to the investing table, it's clear that there are some major challenges. They fall into a regulatory gray area, and have quickly turned into a Wild West of investing. At best, an ICO-backed company might fail to deliver. At worst, the company is an outright scam.

According to a report by Boston College, more than half of all ICOs failed within four months of completing their fundraising. But it wasn't just incompetence. There were a number of scammers conducting their own ICOs as well. The top ten ICO scams made off with $700 million of investment.



Common Headlines from ICO Scams in the past two years

These bad actors are part of an unfortunate reality that exists in any industry, but we must remember not to let them deter us from the benefits that the blockchain can bring. Fortunately, many of the greatest minds from finance, economics, and technology are dedicating time, energy, and money to the continued development of the blockchain.

Back to Top

By combining these productive conversations with advancements in its technology, we are on our way to what we'll call IPO 3.0: security token offerings (STOs).

IPO 3.0: STOs as an investment vehicle

STOs are the latest innovation in blockchain-enabled fundraising and investing.

There are still some gray areas based depending on your geographical location, but, STOs solve many of the problems that ICOs cannot. From a company's perspective, they offer an avenue for a business to be more compliant with the laws and regulations. From an investor's perspective, they're a more secure way to invest in upcoming companies, unique asset classes, and a larger global base of opportunities with a low barrier to entry.

In the next chapter,we'll dive into what STOs are, how they work, and how they differ between ICOs and IPOs.

Back to Top ▲

Chapter 2: Security Token Offerings 101: Everything You Need to Know

For many years, IPOs were the primary way for investors to participate in entrepreneurship value creation. But there was a problem: they were (and still are) exhausting their value to wealthy investors through private funding rounds before average investors have a chance to participate. The vast majority of other profitable companies still lack the resources necessary to participate, and investors will never gain access to those either.

To bridge this gap, companies began using initial coin offerings (ICOs) to lower the barrier and to make investing more accessible for all. Anyone could theoretically participate in an ICO if they wanted to, and the blockchain technology powering it made investing in these new startups easier than ever. But ICOs suffered a few blows as they became more popular: low returns, empty promises, and scams that took an estimated $700 million from investors' pockets into the hands of frauds.

Although ICOs were a step in the right direction, the system remained flawed. It needed better management and regulation to succeed.

Then, in July 2017, the SEC clarified with their ruling on The DAO that nearly all ICOs were considered securities, and all ICOs were beholden to the same regulations as conventional securities.

That's when the concept of security token offerings (STOs) was born, and the idea has only gained momentum ever since. STOs will solve the problems that plagued the old IPO ecosystem: high barriers to entry, limited geographical access, and inflated valuations that make wealthy investors richer and leave average investors holding the bag.

Back to Top ▲

STOs will also address the problems that ICOs faced, such as unclear regulations and a Wild West mentality that deterred many.

Before you can understand the impact STOs stand to make on the investment world, we need to address some token basics: what is a token, what classifies a token as a security, and why STOs are more effective investment strategies than IPOs and ICOs.

What is a token?

Let's address one thing right away: tokens are not physical items. You can't hold them in your hand, and they don't go into arcade machines.

Just as you might purchase ownership in a company via IPO or ICO, tokens represent digital shares in a company or asset. This ownership is stored and verified on the blockchain.

The underlying nature of blockchain technology gives token holders the ability to trade quickly and cheaply without any of the middlemen or gatekeepers that traditional investing requires.

But not all tokens are created equally. They can be divided into two broad categories:

- **Utility Tokens** allow the holder to perform a specific function on the token's native platform: think online arcade games or slot machines..
- **Security Tokens** entitle the holder to a share of a company's success: think of it as similar to equity and dividends from conventional investing.

These definitions of token types can be murky, but the SEC determined in July 2017 with their ruling on The DAO that most (if not all) ICOs were beholden to regulations. The world's regulatory agencies generally followed suit and took the same stance. Many countries allowed them if the ICO abided by specific regulations, but countries like China and North Korea went so far as to ban them all outright.

Back to Top ▲

SEC Chairman Jay Clayton on regulating cryptocurrencies

In June 2018, SEC chairman Jay Clayton reiterated that a token is a digital asset in which "I give you my money and you go off and make a venture, and in return for giving you my money I say, 'you can get a return.' That is a security, and we can regulate that. We regulate the offering of that security and regulate the trading of that security."

To avoid any future misunderstandings or mislabeling, the SEC emphasized the importance of the Howey test. This test determines whether or not something is considered a security. It says something qualifies as a security if:

The Howey Test

- It is an investment of money
- There is an expectation of profit from the investment
- The investment of money is in a common enterprise
- Any profit comes from the efforts of the promoter or third party

The Howey test makes it clear that most tokens, despite claiming to be utility tokens, are actually securities in the eyes of the regulators. The conversation around STOs only became more popular as a result.

Back to Top ▲

How do security tokens work?

A security token is any asset that has been "tokenized."

Suppose you want to invest in Joe's Pizza Shop down the street. Under security laws, your ownership interest is considered a security. Let's further suppose had quite a bit of money to invest, but now you need some cash and want to sell your ownership. The questions are: who will buy your shares? How do you find these people?

This is where security token offerings come into play.

Because your ownership is represented by a digital token, you have far more options for selling your shares to anyone around the world versus limiting yourself to the people within your network or town. Security tokens are of little interest to big companies like Apple because they already have access to lots of global liquidity. But for small businesses, startups, and select assets classes like real estate, liquidity is often a major challenge.

Security tokens meet this challenge head-on by giving investors opportunity to sell their shares to anyone in the world in the fastest and most efficient way possible.

[To read more about the benefits of security tokens, jump to chapter three]

What are the different types of security tokens?

There are different types of security tokens, including:

- **Equity**: partial ownership of a company or project.
- **Debt**: a company's outstanding liabilities, comparable to a bond or mortgage.
- **Royalty**: a return on your investment, and a form of passive income.

All security tokens need to abide by the compliance rules set forth by the regulatory party in each country. This ensures that all tokens are lawful and secure, therefore protecting the token holder's investment.

The versatility and regulatory nature of the different types of security tokens shows a lot of promise for the future. But what excites us the most at 81-C is the potential for asset-backed security tokens.

Back to Top ▲

What are asset-backed security tokens?

Unlike the majority of ICOs (which were startups without a proven business model and oftentimes didn't have a product on the market), a lot of the excitement around security tokens comes from their ability to create tokenized securities backed by digital assets.

Asset-backed security tokens are based on established real world assets. This means they open up the avenues for investors to purchase and trade assets that were previously very difficult to access.

Small businesses are a strong example of the potential here. Investing in a local business was previously limited to people within that geographical location. Someone in China was highly unlikely to invest in a grant writing business in Florida. It's likely that the investor would never have discovered the opportunity in the first place, and even if they did, they would have a hard time finding a buyer when the time came.

Another use case for asset-backed securities is in property and real estate. These investment classes generally struggle with liquidity. But if the investment were tokenized, this would stand to solve that problem gracefully. For instance, an investor in South Africa could purchase digital shares in an apartment building in San Bernardino, and then turn around and sell to an investor in Australia the next day.

The ability for anyone to invest in securities that are backed by true assets, and then easily trade them with anyone in the world, represents a major shift in the financial landscape.

Back to Top ▲

What's the difference between an ICO and an STO?

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ICOs

- ✓ Accessible for retail investors
- ✓ Relatively easy to set-up
- ✓ Don't have to sell equity as a company
- ✗ Investors hold all the risk
- ✗ Liability for legal trouble
- ✗ No tangible product, service, or underlying asset
- ✗ No protection (and reassurances) for investors

STOs

- ✓ Meet regulatory criteria
- ✓ Protection against fraud
- ✓ Tied to securities
- ✓ Reassurance to a certain extent
- ✓ Connects financial worlds
- ✗ Complex regulation paperwork
- ✗ Edges out retail investors (for now)

In simplest terms, an ICO is "crowdfunding on the blockchain." Founders create their own tokens and sell them on a platform like Ethereum, Waves, or NXT to raise money for their projects. Investors can purchase these tokens on the premise that their value will increase over time.

This sounds like an effective on-paper solution to the problems faced by IPOs, but ICOs land in a regulatory gray area. Many companies abused this loophole in order to take advantage of investors.

STOs were created to close these gaps. Similar to an ICO, they completely lack that Wild West nature. STOs are a regulated investment instrument.

In the United States, the Securities Exchange Commission (SEC) regulates STOs and provides investors with more rights and better protections that are completely missing from ICOs. Outside of the US, each country has its own version of the SEC, which provide similar guidance to encourage STOs over ICOs.

Back to Top ▲

Why security tokens matter

ICOs were a way to transform how people invest in companies, but ultimately fell short due to how they interact with regulations. IPOs were designed to provide people with the ability to invest in entrepreneurial ventures, but they favor wealthy investors and are geographically limited.

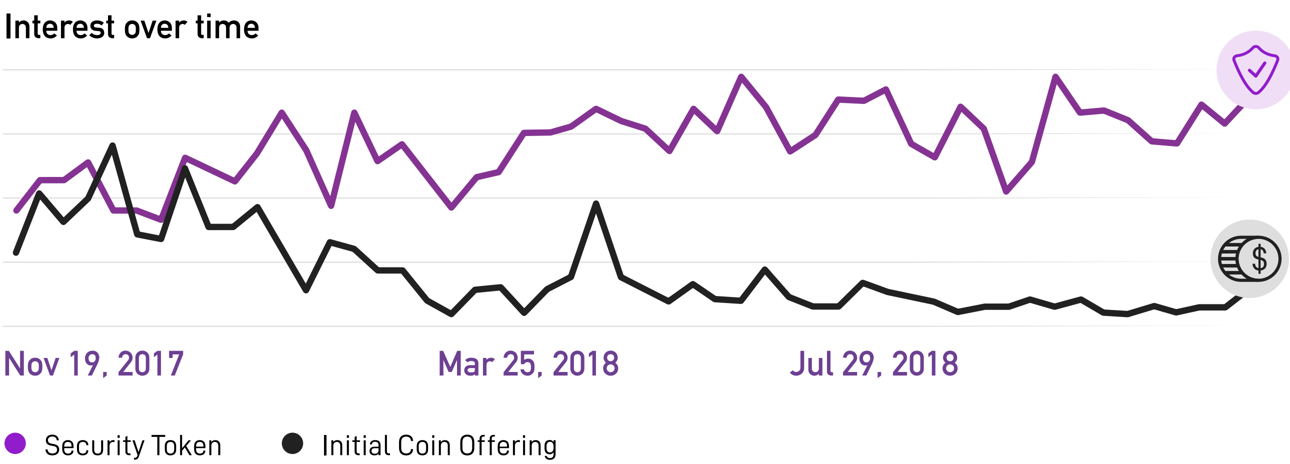
STOs deliver on the promises that IPOs and ICOs couldn't. They take the public funding aspect of IPOs, mix it with the global, decentralized nature of ICOs, and deliver a new wave of global investing opportunities to the public.

Now that we've covered STOs are at a high level, we'll dive into the core benefits of security token offerings and what they specifically provide to investors.

Back to Top ▲

Chapter 3: The Key Benefits Of Security Token Offerings

There's a lot of hype around STOs, with many blockchain enthusiasts and cryptocurrency thought leaders calling it the next big thing. And there's a lot to be excited about: low cost of entry, seamless transactions, integrated compliance, and global access. All of these factors have a significant chance of drastically impact the way investors can invest and how companies can raise capital.



STOs are presently making their way out of the infancy stage. In the US and other major global markets, they are still only available to accredited investors. But many industry professionals expect this to change in 2019, when this opportunity will open to the general public.

When STOs are available to everyone, we expect to see a dramatic shift in the way things are done. After covering the 101 of security token offerings, we'll dive into the most important question of all: why should everyday investors care about STOs?

The benefits of security token offerings

It's generally a struggle to invest.

Consider the stock market's fluctuating highs and lows, an IPO drained of its value by the time it reaches the retail investor, and the Wild West nature of ICOs. It seems as though investing is safer with a menial 401(k). But investing doesn't have to be this way. It can be much easier with STOs.

Back to Top ▲

STOs have a low barrier to entry.

Investing has gotten easier in the past few years, but there's still a long way to go. STOs stand to make investing in a company as quick and easy as ordering something from Amazon.

STOs are available around the world.

STOs advance financial inclusion because they are available to everyone. They open up the possibility for someone in Africa to have the same access to opportunity as someone in Miami. The technology makes it possible for anyone in any location to trade securitized assets with ease.

This is quite unlike how conventional stock market exchanges operate. Those are highly localized and have significant barriers for international investors.

STOs represent a new class of investment.

Despite being home to 32 million businesses, America only has 4,000 public companies to its name. The high costs associated with the process of taking a company public makes it unlikely that these companies will IPO any time soon. The opportunity to invest in them will never be available to the average investor. STOs offer a way for companies to raise capital without going the IPO route.

This means investors aren't limited to investing in the few companies that go through the expensive, time-consuming IPO process. Their valuations are often based on hype and buzz — think when Snapchat went public as Snap, Inc.

Investors will gain the ability to invest in smaller companies with established business models, proven cash flow, and consistent profits without those companies ever going conventionally public.

STOs offer increased liquidity.

Security tokens are well-positioned to provide liquidity to investments that would otherwise be difficult to trade in the everyday stock market. Security tokens have a global reach that lets investors anywhere in the world buy, sell, and trade tokens. There are far more options to liquidate investment here.

Back to Top ▲

STOs offer better investor protection.

The simple truth is that STOs are regulated and ICOs are not. This means investors in an STO enjoy all the benefits of an ICO without any of the scammy drawbacks.

STOs are a more affordable investment vehicle.

It's extremely expensive for a company to go public on a major exchange, it's not just a one-time expense. Costing $750,000 and taking 18 months to complete, the typical IPO process, it costs $1 to 1.9 million per year just to be a public company.

Cutting these costs may sound like a perk for the company alone. For the investors backing these companies, it begs the question: would you rather have this company spend its resources on compliance and legal expenses, or on marketing, sales, research, and development?

STOs let companies offer themselves as investments to the public at a cheaper cost than a traditional IPO. It's a win-win scenario for the company and its investors.

STOs are hard-coded to be compliant.

Blockchain technology makes it possible to design a digital ecosystem that automatically follows all the rules, no matter what. This reduces the need for a company to devote its resources to lawyers and other contractors that might have previously performed these functions.

STOs represent partial ownership in a company or project.

Suppose you were investing in an 18-unit apartment building worth $3 million. This type of investment would usually go through an investment fund or a collection of entities coming together to invest. Let's say this apartment complex is owned by six investors who all contributed $500,000 each.

Back to Top ▲

An STO would make it possible for the same apartment complex to have many more investors on top of this six. One thousand investors might contribute $1,000 each. These shares in the apartment complex could then be easily traded like shares of stock to anyone no matter where they were in the world.

STOs face unpaved roads ahead

Just because there's a lot of promise here doesn't mean there aren't any challenges ahead.

To live up to their full potential, STOs need to become accessible to less technologically sophisticated investors, as well as investors less tolerant of risk. But the reward of an open investment market is worth the uphill climb. Once this happens, STOs will be in position to make the financial world more inclusive than ever before.

In the next post, we'll dive into the challenges STOs need to overcome on their way to meeting their potential.

Back to Top ▲

Chapter 4: Top 4 Challenges That STOs Face

When ICOs proved to be a Wild West-style financial environment, many investors questioned the validity of blockchain investment opportunities. Their complete lack of regulation brought scams and darkness to the surface, proving a need for something better.

Security token offerings (STOs) are rising to this challenge. They are just as inclusive as ICOs, built on the same ideas as the conventional IPOs, and yield a system in which anyone with a reliable internet connection can buy a tokenized version of a real, tangible asset.

While security tokens show promise for investors and entrepreneurs alike, they need to overcome several challenges claiming mainstream membership in an average investor's portfolio. At present time, STOs are only available to accredited investors.

Here are three of the biggest challenges that STOs will face on the horizon.

STOs need clear global regulations.

Security tokens have the technology to let people anywhere invest in a company or project. They are simultaneously very secure because they are powered by blockchain technology, which processes transactions in an unchangeable way. But before STOs can go global, they need global regulations.

In July 2017, the SEC set the tone with its ruling on a token called DAO. The regulator determined that "offers and sales of digital assets by 'virtual' organizations are subject to the requirements of the federal securities laws."

This means ICOs were basically STOs in a bad disguise. This determination changed the money-grab mentality that dominated ICOs at their peak in 2017. The ruling also established that blockchain-enabled investing needed to be regulated in order to protect investors and companies alike.

Back to Top ▲

Other countries followed suit, establishing their own rules for security tokens. Sweden established regulations via the Swiss Financial Market Supervisory Authority (FINMA) that distinguishes tokens into three separate buckets: payment tokens, utility tokens, and asset tokens. In Canada, the Canadian Securities Administrators (CSA) established that any ICO must first speak with the regulators themselves to determine if theirs is a security token. On the other hand, countries like China and Korea have simply banned them outright.

It is important that every country in the world find a way to on a set of specific regulations for security tokens. Once in place, these rules will prevent companies from setting up operations in the country with the least regulations or otherwise misrepresenting themselves.

STOs need an established ecosystem of security token exchanges.

One of the biggest challenges to widespread STO adoption is building a way for people to buy and sell them easily.

To live up to the promise of providing liquidity to investors (a primary benefit of STOs), we need an infrastructure of global exchanges. This will let investors anywhere in the world easily buy, sell, and trade security tokens. Without them, there will be no place to trade on a global scale. These exchanges will also keep security tokens from being localized to a specific country, or from being dispersed across smaller exchanges.

Several exchanges are emerging nowadays, and there is talk among traditional stock exchanges about offering their investors the opportunity to trade in these securitized assets. At this present moment, there are no brand-name players in the space.

An exchange ecosystem will entice new investors and build a vibrant community. They will not only need to be functional and accessible, but user-friendly as well. STOs are still looking for their "killer app," bringing smartphone-style convenience to such niche financial space.

Back to Top ▲

Trusted and established global exchanges will let the STO world compete (in terms of liquidity) with traditional established equity markets. Current equity markets are large, but their geographic limitations prevent them from going global. A truly global STO equity market would eclipse these markets if participants could buy and sell on approved exchanges.

STOs face an education problem and a lack of trust.

The rise (and subsequent fall) of ICOs left a bad taste in many investors' mouths. Their lack of accountability and unregulated nature had many people questioning them as a safe investment vehicle. This gives STOs an uphill battle right from the start, which is why it will be important to focus on education.

When the dot-com bubble burst in the early 2000s, it would have been easy for investors to write tech companies off as too risky. But doing so would have resulted in many missed opportunities. There's no denying that ICOs underwent a similar process in 2018, but the industry as a whole has entered into a period of productivity.

It's more critical now than ever for industry leaders to educate investors on the pros, cons, and possibilities in the STO world.

The technology that powers STOs can be called immature.

Blockchain technology just recently celebrated its tenth birthday. In the past decade, the bitcoin market cap went from being worth effectively nothing to having a market cap of over $62 billion.

Ten years is not a long time for any technology. Consider the internet even 20 years ago, with dial-up internet just taking shape, the first websites going live, and Yahoo! starting out as a company. It was an era of similar buzz and possibility, but there were also many naysayers who couldn't wrap their heads around what the internet was or why it mattered.

Back to Top ▲

Consider this excerpt from a 1995 Newsweek article titled "Why the Web Won't Be Nirvana."

"[Today] I'm uneasy about this most trendy and oversold community. Visionaries see a future of telecommuting workers, interactive libraries and multimedia classrooms. They speak of electronic town meetings and virtual communities. Commerce and business will shift from offices and malls to networks and modems. And the freedom of digital networks will make government more democratic. Baloney. Do our computer pundits lack all common sense? The truth in no online database will replace your daily newspaper, no CD-ROM can take the place of a competent teacher and no computer network will change the way government works."

It turns out the author was dead wrong, but his general sentiment towards the early internet is similar to how many people feel about the blockchain today. To overcome this, the industry as a whole will need time to mature and evolve.

Eventually it will reach a point where its possibilities just speak for themselves and the critics will be silenced. The internet's already done it once.

Let's prioritize STOs over ICOs from now on.

Comparing STOs to its predecessors brings out its strengths over IPOs and ICOs.

IPOs are one of the most popular investment types, yet they offer decreased value the farther down the ladder you are as an investor. If you're not a private firm or accredited investor, then you're missing out on the majority of up-front value created from IPOs.

Back to Top ▲

ICOs quickly blossomed to fill this gap, but ultimately fell short too. They were designed as a more affordable, faster way to raise money, but ICOs morphed into a lawless world because there were no regulations governing the space. Many ICOs were selling people on ideas through a website and a whitepaper, then simply taking their money and disappearing.

STOs solve both of these problems head-on: they open up investing to anyone, and their tokens abide by regulatory laws to ensure companies and investors are both protected. STOs are the next logical step in leveling the investment playing field.

There are challenges ahead, but through education and regulation, STOs will earn their place at the table.

In the next post, we'll dive into the the current state of security token offerings in 2019.

Back to Top ▲

Chapter 5: The State Of Security Token Offerings In 2019

ICOs were all the rage throughout 2017 and 2018, but as multiple ICO-backed companies failed to live up to their promises and as regulatory bodies clarified ICO misconceptions, the buzz began to settle.

ICOs were no longer the safe gold mine everyone thought it might be. The complete lack of regulations governing ICOs yielded a lawless environment, letting many "pump-and-dump" schemes take place. But this was just one of many disappointments that ICO investors faced. Many people said goodbye to their money after certain projects or companies found themselves unable to deliver on their ideas. One study suggests that only 44 percent of ICOs are still active within four months of raising money.

Because of these high failure rates, empty promises, and overall unregulated nature, ICOs are falling out of favor while security token offerings (STOs) gain traction as the next generation of blockchain-enabled fundraising.

STOs take the best of ICOs (like their open-door investment policy) and refine it with a stable, legally compliant roadmap. They're steadily rising to meet the overwhelming desire for a more reliable and controlled equity crowdfunding space.

Regulations to patch the holes

ICOs challenged conventional forms of fundraising and investing by moving it to blockchain. Then they redefined how quickly companies can raise money. Take the popular messaging platform Telegram, which held an ICO and raised $1.7 billion in one month.

Many illegitimate companies also took part in ICOs. With little more than a whitepaper and a website, they made amounts of money from eager investors. But despite some bad actors, ICOs were riding high: in 2017, there were approximately 876 ICOs. This growth was impacted when SEC chairman Jay Clayton said that "every ICO I've seen is a security."

Back to Top ▲

Their ultimate demise began as everyone realized they needed to file for exemptions and transition to becoming a security, or else stop doing business outright. Multiple ICOs in the US were fined and some received cease-and-desist letters.

Other countries put ICOs under the microscope to figure out how to regulate them. Canada, Switzerland, and Israel (among others) allowed ICOs as long as they held to strict regulations, but other countries weren't so kind. Here are the countries that outright banned ICOs:

- Algeria
- Bangladesh
- Bolivia
- China
- Ecuador
- Macedonia
- Morocco
- Nepal
- Pakistan
- South Korea

This lack of global regulation hurt the growth of ICOs. Without worldwide acceptance, ICOs will fail to make a global impact. But that's where STOs shine in comparison.

Unlike ICOs, STOs are treated as securities from the start, and therefore must abide by a rigorous set of regulations. This makes it much easier for regulators because they don't have to question whether or not something is a utility or a security.

Back to Top ▲

Here is a short list of the regulatory bodies that are responsible for governing STOs in their respective countries, along with their stance on STOs:

- **Securities Exchange and Commissions (SEC) - United States**

  If a token is deemed a security by the Howey test, it is subject to regulation by the SEC. STOs can file for different exemptions with regulations to the Jobs Act.

- **Canadian Securities Exchange (CSE) - Canada**

  The CSE announced the creation of their own securities clearing and settlement platform on blockchain that will enable companies to issue conventional equity and debt through tokenized securities.

- **Monetary Authority of Singapore (MAS) - Singapore**

  All users of security tokens must adhere to the Singapore Securities and Futures Act. iSToX, a security token exchange which allows investors to purchase tokens with fiat money, is still pending licensing from the MAS.

- **The European Securities and Market Authority (ESMA) - EU**

  There is no EU-wide regulation governing the use and sale of tokens. Some of the smaller states within the EU (like Gibraltar and Malta) have created their own regulatory frameworks to govern ICO-related activities.

- **The Financial Services Agency - Japan**

  STOs must abide by the rules for either Type 1 or Type 2 securities.

These countries and others are working toward shared ground rules for STOs. This is a step in the right direction, but STOs will thrive once a global set of regulations comes to pass.

Back to Top ▲

Better investment options through STOs

IPOs are the usual way an average person invests in a company, but this system is broken.

The exchange handling their transactions in extremely localized. Many investment portfolios lack international companies because of the geographical limits of current stock exchanges. But STOs can change this by offering investments for all, a truly global exchange.

With a set of global regulations in place, anyone can become an investor. This works twofold: investing now has a low barrier to entry for investors, and this previously unavailable global market is open to companies seeking capital.

STOs are also refining investment opportunities by providing people with the ability to invest in previously unavailable opportunities. ICOs familiarized everyone with crowdfunding on the blockchain, but they lacked concrete investments. ICOs asked investors to give them money in exchange for a future project or service, and was only backed by a whitepaper and a promise. This left some investors victims of scams and misrepresentations.

Security tokens are backed by real-world assets. These assets guarantee ownership and individual rights like voting. STO investors are responsible to the company, and the company has a responsibility to them in return.

Back to Top ▲

Who is using STOs to raise money?

Top companies recognize the advantages of STOs for accessing more capital. Consider tZERO, a blockchain subsidiary of Overstock.com. The company makes a fully compliant platform for trading tokens. They held an initial ICO, but after oversight from the SEC, they transitioned to an STO in March 2018. Their STO wrapped in August 2018, and it raised approximately $134 million.

Other companies with decentralized products are also using STOs to raise capital:

- **Gab** is a new free speech social media platform that is actively working against censorship, data collection, and siloing. This "neutral platform" raised upwards of $630,000 in under three weeks through their Regulation Crowdfunding (CF) campaign on StartEngine.
- As an alternative option to popular ride-sharing services Uber and Lyft, **Ridecoin** is redefining the taxi service with the blockchain, creating a peer-to-peer decentralized transportation system. Ridecoin will connect passengers to drivers without any middleman, so they can afford to pay drivers more and add to the sharing economy. They also let passengers pay more if they're in a hurry, and less if they're not in a rush. Ridecoin released both a security token and a utility token to its investors.
- The Aspen Digital security token is proof that there are no limits to tokenization. Hosted on the Ethereum platform, their security token offers investors an option to get partial ownership in the St. Regis Aspen Resort in Aspen, Colorado. Importantly, this offering is only available to accredited investors under Regulation D Rule 506(c).

STO adoption starts at the top

STOs are only beginning to gain traction as people see the weaknesses in ICOs and grow frustrated with the traditional IPO ecosystem. But there's a lot of education to be done before STOs gain traction with the average investor. As with any new technology, it's daunting (and downright scary) until the advantages and usability are clearly laid out.

Back to Top ▲

There are some forward-thinking companies in the securities market who are helping STOs get on their feet. One of these companies is **Polymath**, a decentralized platform used for the creation of security tokens. They're helping companies create their tokens, reserve a ticker symbol, and set parameters for their token (like the maximum number of investors and maximum percentage of ownership per wallet address).

A similar platform is the Open Finance Network (OFN), created specifically for security tokens. OFN is backed by a team of securities lawyers and exchange technologists to ensure safe, compliant trading on their exchange.

There are also some other security token platforms specifically focused on investing:

- Harbor is a blockchain-based platform that is used for private investing in tokenized versions of commercial real estate and investment funds.
- BnkToTheFuture is similar to Harbor. It's an online investment platform for qualified investors, with investments focused on fintech.

As more companies see the value in tokenizing investments, security tokens will gain more acceptance and mindshare. Their use of blockchain technology will bring clarity and security to investments so that no one is left in the dark.

With strong regulatory guidelines to protect investors, they're set to reinvent the future of investing. If 2018 was the year of understanding ICOs, then 2019 will be the year of people getting into them.

In the next post, we'll dive into the future of security token offerings and why they will become the new global investment opportunity.

Back to Top ▲

Chapter 6: The Future Of Security Token Offerings

As ICOs fall out of favor and cryptocurrencies enter a bear market, many people are wondering what this blockchain thing is all about. Is the cryptoworld all it's hyped up to be?

To redefine investing and show the true potential of blockchain technology, security token offerings (STOs) are taking the stage. The next few years will be an exciting time for this financial technology, especially if it overcomes the roadblocks that are keeping it from global adoption.

Here's what we see happening on the STO battlefront in the coming years.

STOs will set the stage for a global marketplace

As STOs gain momentum as the newest form of equity crowdfunding, they'll become the foundation for a global marketplace. Their underlying blockchain technology helps set the stage: availability for anyone who wants to participate, security through a distributed ledger, and transparency for all transactions.

This exposure to global markets is unlike other investment opportunities, all of which have been more or less localized. It's been tough to invest in other companies around the globe because of these market constraints.

But STOs eliminate these boundaries because anyone anywhere with an internet connection can invest. There are no limits as long as global regulations for all participants exist.

STOs are laying the foundation for global regulations because they are regulated from the start. They don't have to worry about a regulatory agency scrutinizing their token sale because they need to follow securities regulations in order to exist. Some token platforms seamlessly integrate the tiring process of anti-money laundering (AML) and know-your-customer (KYC) requirements into token creation, making regulation much easier.

Back to Top ▲

STOs will open up investment opportunities to more people

A huge advantage to STOs is that they can be used for any type of asset: real estate, art, stocks, bonds, and beyond. Anything can be tokenized for ease of transfer. But don't confuse these tokens with what their ICO predecessors were doing. There is one big, important difference: security tokens represent real-world assets instead of empty promises.

With STOs, investors aren't blindly throwing their money at ideas — they're investing in tangible things.

STO adoption rates will dramatically increase

The public watched as many US-based ICOs fell victim to SEC rulings. But this isn't because the SEC is an overbearing government agency. Instead, their regulations are geared toward protect investors from companies that misrepresent themselves.

In an uncertain ICO ecosystem and an even more unstable internet, this regulation will be gladly welcomed by individuals who want more security and stability. STOs with solid operations and cash flow are more stable as opposed to risky, speculative startups with wild swings in market cap and no underlying value.

Once the public is knowledgeable on the inherent value of STOs, the next big jump will occur when they are introduced to the public market. We will see more mainstream adoption by less technologically sophisticated investors and fewer risk-tolerant value investors who are looking for measurable opportunity instead of speculation.

STOs will open up to the general public

In the majority of today's markets, only accredited investors can invest in STOs. In the coming year, many industry professionals expect this to change, and STO investment opportunities will open to the general public.

When the available market goes from a limited number of private investors to the general public, anyone anywhere gets to participate. We believe this is where we'll see the greatest fundamental shift.

Back to Top ▲

STOs will challenge the conventional finance industry

Widespread STO adoption will challenge traditional financiers. This has always been a fear, ever since blockchain technology started appearing across industry verticals. But STOs will be a real thorn in their side.

Despite the fact that banks, financial advisors, and investment firms have adopted new technologies, their systems are entirely antiquated. Just look at the remittance industry: it can take days or weeks to send money to someone.

With STOs and the power of blockchain, transactions can happen instantly. There's no waiting period or middlemen to pass through. The element of speed will play an important role in financial inclusion, because investors won't be limited based on time or money. The only limit will be the speed of their internet connection.

Prospective investors previously needed to work with a broker dealer or other middleman that charged fees for their services. Beyond that fee, these professionals also charge a percentage for all of your assets under their management. Sometimes, only accredited investors would be granted access to private funding rounds — all because they had more wealth and were assumed to be better with handling money. But STOs will level the playing field. More people will have increased access and knowledge. STOs will deliver a way for everybody to access the value created by entrepreneurship for the first time, which will contest the old school way of investing.

STOs picked up the equity crowdfunding ball when ICOs dropped it. According to a 2018 annual report by Inwara, STOs hit an all-time high in October 2018 with a total of 22 STOs. The investment and trading industry led the pack, with technology and financial services not too far behind. If anything, these findings spell out a trend that more companies are seeing the liquidity advantage that STOs offer to real-world assets.

The notion that investing is only available to individuals with industry knowledge and money is false. Anyone can be an investor if they use STOs. They're proving that investing doesn't mean settling for less than you deserve.

Back to Top ▲

About 81-c

At 81-c, we created a solution to contribute to the global challenge of financial inclusion by growing entrepreneur-led small to medium sized enterprises and making them accessible to everyone. Our proprietary scaling method allows for rapid growth and value creation that we make immediately available to the public.

The 81-c approach is revolutionary as it delivers, for the first time, a way for everybody to access the value created by entrepreneurship. It also unlocks maximum value for entrepreneurs who can now source previously untapped capital and resources. So it's a win-win for 81-c entrepreneurs and the investing public.

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