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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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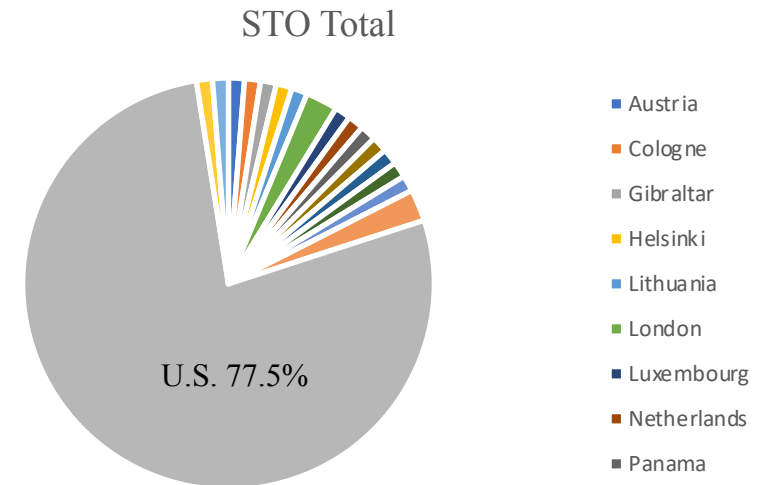
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Preface

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 I report, we will discuss two cases for Regulation A+ STO and Regulation CF STO. Please well noted that nothing published in this report should be regarded as investment advice or an endorsement for any project.

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Regulation A+ Offering

Official Guide

Regulation A is an exemption from registration for public offerings. Regulation A has two offering tiers: Tier 1, for offerings of up to \$20 million in a 12-month period; and Tier 2, for offerings of up to \$50 million in a 12-month period. For offerings of up to \$20 million, companies can elect to proceed under the requirements for either Tier 1 or Tier 2.

Source: <https://www.sec.gov/smallbusiness/exemptofferings/rega>

Regulation A+ Offerings

Scopes

a. Eligible Issuers and Securities

Regulation A+ Tier 2 Offering is only available to companies organized and doing business in the U.S and Canada. Besides, the asset-backed securities are excluded from the list of eligible securities.

b. Offering Limitations and Secondary Sales

Tier 1 is available for offerings of up to \$20 million in a 12-month period, including no more than \$6 million on behalf of selling securityholders that are affiliates of the issuer. Tier 2 is available for offerings of up to \$50 million in a 12-month period, including no more than \$15 million on behalf of selling securityholders that are affiliates of the issuer.

c. Investment Limitations

For an non-accredited investor under Rule 501(a) of Regulation D, the purchase in a Tier 2 offering is limited to: (a) 10% of the greater of annual income or net worth (for natural persons); or (b) 10% of the greater of annual revenue or net assets at fiscal year end (for non-natural persons).

d. Integration

Regulation A, however, provides issuers with a safe harbor that offerings conducted pursuant to Regulation A will not be integrated with prior offers or sales of securities or subsequent offers.

e. Treatment under Section 12(g)

Issuers in Tier 2 offerings are required to engage the services of a transfer agent registered with the Commission pursuant to Section 17A of the Exchange Act in order to apply for the conditional exemption of the Commission registration.

Regulation A+ Offerings

Issuance

Target Funding

Companies target to raise no more than \$50 million capital

Investor base

Since Reg A offerings are able to accept funds from both accredited and non-accredited investors, companies target to a more extensive investor base will issue mini IPO to raise fund.

Reputation

Regulation A Offering give the fund-raising companies to brand their images and build reputation. Companies with ambitions to promote their publicity will choose to issue regulation A offerings.

	Reg A-Tier 1	Reg A-Tier 2
Maximum Offering	\$20,000,000.00	\$50,000,000
Investment Limitation	All, including non-accredited investors	All, including non-accredited investors
General Solicitation	Unrestricted	Unrestricted
Offering Document	SEC Review & State Review	SEC Review
Financial Disclosure	Reviewed Financials (Certain states require audits)	Audited Financials
Ongoing Disclosure	No Ongoing Public Financial Reporting	Annual & Semi-annual Public Reporting Including Audits
Ability to Terminate Ongoing Reporting	N/A	Less than 300 holders of Reg A stocks
Transfer Restriction	None	None

Source: <https://www.seedinvest.com/blog/jobs-act/raising-capital-reg-a-mini-ipo>

Regulation A+ Offerings

Process and Timeline

File with SEC & Test Market

Filed 1-A form with SEC and enter into “test the water” status, allowing investors to reserve shares.

Trading

The securities are secondary traded at registered & regulated platform among investors after the close of the offering.

Day 0

Day 30

Day 120

Future

Preparation

- (i) Assemble a team with auditors, lawyers, transfer agents, consultant.
- (ii) Prepare the audited/reviewed financial statement
- (iii) Prepare the offering statement and other SEC filing documents.

Issuance

After receiving the “notice of qualification” from SEC, the issuance goes alive, the issuer is permitted to sell or distribute securities in regulated platforms in 12 consecutive months.

Ongoing Reporting

Annual and semiannual reports, as well as current reports and, in certain circumstances (Tier II), an exit report on Form 1-Z, with the Commission on EDGAR.

Regulation A+ Offering

Case Study: StartEngine

Company Introduction

StartEngine is a crowdfunding, ICO and STO platform, facilitating investment for start-up businesses. Founded in 2014, StartEngine has helped nearly 150 companies to raise capital by equity crowdfunding or ICOs under regulation CF, D, and A+. Based on the company's financial report, StartEngine has achieved a revenue of 2,421,061 in the most recent fiscal year. On the SEC's and FINRA's approval of StartEngine as a broker-dealer and Alternative Trading System, StartEngine plans to operate a secondary marketplace for security tokens in the coming future.

Reg A+ STO Case Analysis

StartEngine Reg A+ Offering

Basic STO info

Regulation A+ Offering: Tier 2

Common shares(tokens):
Up to 1,000,000 shares
\$10 per share
\$500 minimum investment
No voting right

Preferred shares(tokens):
Up to 1,136,363 shares
\$8.8 per share
\$200,000 minimum investment

The company is seeking to raise up to \$10 million.
The shares of Common Stock and Preferred Stock
will be recorded in the form of Tokens on the
Ethereum Blockchain.

STO service provider

Escrow Agent: Prime Trust

Registered Transfer Agent: StartEngine Secure

Legal Delegate: CrowdCheck Law

Auditor: dbbmckennon

The company has not engaged commissioned sales agents or underwriters. The company will use its existing website, www.startengine.com, to provide information with respect to the offering.

STO Fees & Expenses

Audit Fee: \$22,000
Legal Expense: \$35,000
State Filing Fee:\$10,000

Escrow Service Expenses:

- (i) a license fee of \$2.50 per transaction processed
- (ii) \$250 for escrow account set up fee,
- (iii) \$25 per month for so long as the Offering is being conducted, but in no event longer than two years
- (iv) \$2 per domestic investor (individual) and \$5 per domestic investor (entity) for AML check and \$75 for international investors (entities))
- (v) \$3.00 per investor (one-time accounting fee upon receipt of funds)
- (vi) a cash management fee of 1% of funds processed
- (vii) any applicable fees for fund transfers

Reg A+ STO Case Analysis

StartEngine Reg A+ STO Timeline

06/29/2018

Filed with SEC

StartEngine first filed 1-A form with SEC at the end of June, 2018. **The company stepped in “test the water” status**, allowing investor to reserve shares

08/29/2018

Amended 1-A Form

StartEngine filed amended 1-A form with SEC to announce that the offering **will accept Bitcoin or Ether as the consideration** of the Common shares, Preferred shares and tokens.

11/01/2018

Secondary amended 1-A Form

StartEngine filed its secondary amended 1-A form with SEC, **deleting the claim of the acceptance of BTC and ETS as the consideration** of the shares, and adding the content about the risk of STO, KYC/AML process, terms of smart contract, etc.

11/05/2018

Issue new Reg D STO

At the end of October, the CEO of StartEngine, Howard Marks, claimed that the SEC **qualification was expected to delay** given the complexity of the digital securities and planned innovations. In case of the potential failure of Reg A+ STO qualification, the company announced new Reg D STO to raise targeted 10M capital. StartEngine listed its private placement memorandum on its own website to welcome accredited investors to subscribe.

StartEngine Regulation A+ STO

Case Analysis

- **Background Information——Why Regulation A+ Offering?**

As one of the most well-known funding portals, StartEngine launches the most Reg CF offering in the U.S., bringing the company an extensive investor base and a mature marketing team. It is not the first time for StartEngine to run a Regulation A+ Offering. The company already issued a Regulation A+ offering at 2017, which brought StartEngine \$5 million capital. Based on the previous Regulation A+ Offering issuance experience, StartEngine is trying to raise a \$10 million fund in an innovative way (Security Token Offering) to help the company build its secondary trading platform.

- **Why StartEngine? —— Financial & Operating Analysis**

Despite the fact that StartEngine is an early-stage company, the platform has already achieved a revenue of \$2,046,948 in 2017, an increase of 564% since 2016. Such impressive operating result indicates that the company has strengthened its market position with professional services and marketing efforts. StartEngine has started testing the market since the end of June, 2018. The strong financial & operating performance attract large investor interests for the Regulation A+ offering.

- **Why STO on Hold? —— Uncertainties on Digital Securities and Legal Issues**

However, the StartEngine Regulation A+ Offering is still under review of SEC since the end of June. In general, SEC takes 2-3 months to review a Regulation A+ Offering and sends the “notice of qualification”. According to the last statistics from FinTech4Good, 8 companies in total have filed 1-A form with SEC to issue Regulation A+ Security Token Offering. Due to the complexity of digital securities and other legal issues, none of the 8 issuers has been qualified by SEC. At the end of October, the CEO of StartEngine claimed that the SEC qualification was expected to delay.

- **How StartEngine Reacted? —— New Regulation D STO**

The StartEngine STO has gone through so long a reviewing period that investors are concerned about whether StartEngine could compliantly issue the Reg A+ offering. In order to raise fund for future development, StartEngine announced a new Regulation D offering on November 5, sending a signal to the market that the board of the company has no strong confidence on its STO Reg A+ offering but choose an alternative way to raise capital.

- **Market Attitudes towards Reg A+ STO**

Till now, no company has successfully issued Regulation A+ STO due to the conservativeness of SEC, and such situation affect the market sentiment to some extent. In the short run, issuers may play safe and choose Regulation CF or Regulation D instead to raise capital. In the long run, however, as Reg A+ has its unique advantage on issuing rules compared with the other regulations, we believe it has a bright future as issuers won't give up trying.

Regulation CF Offering

Official Guide

Regulation Crowdfunding enables eligible companies to offer and sell securities through crowdfunding. The rules:

- require all transactions under Regulation Crowdfunding to take place online through an SEC-registered intermediary, either a broker-dealer or a funding portal
- permit a company to raise a maximum aggregate amount of \$1,070,000 through crowdfunding offerings in a 12-month period
- limit the amount individual investors can invest across all crowdfunding offerings in a 12-month period and
- require disclosure of information in filings with the Commission and to investors and the intermediary facilitating the offering

Securities purchased in a crowdfunding transaction generally cannot be resold for one year. Regulation Crowdfunding offerings are subject to "bad actor" disqualification provisions.

Source: <https://www.sec.gov>

Regulation Crowdfunding Offering

Scope and Highlights

a. Transactions Conducted Through an Intermediary

Each Regulation Crowdfunding offering must be exclusively conducted through one online platform. The intermediary operating the platform must be a broker-dealer or a funding portal that is registered with the SEC and FINRA.

b. Incorporation and eligibility

The issuer must be incorporated or organized under the laws of a state or territory of the United States, or the District of Columbia. **Certain companies** are not eligible to use the Reg CF exemption. [See JOBS 2. \(d.\)](#)

Crowdfunding Exemption

Maximum Offering	\$1,070,000
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Form Need to File	Form C
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Notice Required to SEC	No specific requirements
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Limits on Unaccredited Buyers	Amount limited depends on annual incomes
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Limits on Accredited Buyers	Amount limited depends on annual incomes
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General Advertising	No prohibition
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Financial Disclosure	Different financial statements requirements based on the amount offered
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Holding Period Before Resale	1 year in general but there are exceptions
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Intermediary	Through one online platform with broker-dealer license
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Subject to Blue Sky Laws	Not subject to
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Regulation Crowdfunding Offering

Requirements for Issuers

c. Disclosure

1. From C

The Form C must be filed and made public prior to the start of the offering.

2. Offering statement Disclosure: Memorandum

information about officers, directors, and owners of 20 percent or more of the issuer;

a description of the issuer's business and the use of proceeds from the offering;

the price to the public of the securities or the method for determining the price,

the target offering amount and the deadline to reach the target offering amount,

whether the issuer will accept investments in excess of the target offering amount;

certain related-party transactions; and

a discussion of the issuer's financial condition and financial statements.

2. From C/A : Amendments to Offering Statement

An amendment to its offering statement to disclose changes, additions or updates to information.

3. Form C-U: Progress Updates

An issuer must provide an update on its progress toward meeting the target offering amount within 5 business days after reaching 50% and 100% of its target offering amount.

4. Form C-AR: Annual Reports

Issuers of securities under Regulation CF are required to provide financial statements prepared in accordance with U.S. GAAP covering the two most recently completed fiscal years (or shorter period since inception).

Reg CF Offering Process

Requirement of intermediary , “Title III” 2. (c)

Each Regulation Crowdfunding offering **must be exclusively conducted through one online platform.**

The intermediary operating the platform must be a broker-dealer or a funding portal that is registered with the SEC and FINRA

1

Preparation

- Select the intermediary
- Find CPAs to prepare audited/reviewed financial statement
- Prepare the document including offering statement, business plan, etc.

2

Filing

- Filed Form C & Amended Form C with SEC via intermediary

3

Issuance

- Issue security token on the designated Intermediary platform
- Intermediary responsible for AML, KYC, investor suitability, as well as the ”bad act qualification” of the issuer

4

Trading

- The transaction will be traded on the selected platform after the holding period

Reg CF Case Analysis

Gab AI Crowdfunding Offering

Background Information of Gab AI

Gab AI Inc. is a social networking platform that offers telecommunications and social networking services, namely, providing live-streaming of video, online chat rooms, and electronic bulletin boards for the transmission of messages among users in the field of general interest.

Basic Information:

Capital raised: \$1,067,287.85
Selling period: 2018/09/19-2018/11/18
Tokens (Shares) sold: 267,947
Investors: 1,892
Purchase price per token: \$4
Type of token: Class B Non-Voting Common Stock
Blockchain: Ethereum Blockchain
Dividend right: Yes
Restriction on transfer: 1 year from the closing of the offering

Service providers:

Auditor: dbbmckennon
Intermediary: StartEngine as the host of the small OPO

Service expenses and fees:

Accounting/Audit fees: 37,500 (Reg A+ Offering document used here)
StartEngine service fee: 6% of the offering amount (covering escrow fees, AML fees, transaction fees, disbursement fees, and SEC filing review)

Reg CF Case

Gab AI Funding Process

Issuing Class A Common Stock

Gab AI started the first crowdfunding campaign via StartEngine on July 2017, issuing the common stock at 1.1 per share and target number of securities to be 9090. On date Nov 15, the offering campaign closed at \$ 1,069,999.70

July 10. 2017

Jan 30, 2018

Regulation A (Tier2) Offering

Gab AI started to seek the Regulation A+ Security Token Offering. Gab AI filed the Form A, disclosed that the number of securities offer is target at \$ 10,000,000

3 Rounds of Form

1-A/A filing

Gab AI submitted three round of comments with SEC, filed the amendment on March 30, June 22, and final filing on Sept 10. Up to now, the Reg A offering has amount of \$5,698,605.64 capital reserved, counted at 1,857 reservations.

June 22, 2018

Sept 19, 2018

Regulation CF Offering

Gab AI started the second crowdfunding campaign on Start Engine, filed the Form C on Sept 19 and set the deadline on Nov 19, 2018. The aim of this filing is to issue Class B Non-Voting Common Stock designated as GAB Tokens. The Target Offering Amount \$10,000 and the target number of securities to be offered is 2,500.

Form C/A

Gab AI filed the Form C/A on the date Nov 11, 2018. The amendment offering statement disclosed the resignation of CTO along with update to use of proceeds and clarification of the blockchain based business model, added material risk factors, an increase the target number of securities to be offered from 2,500 to 10,000

Nov 11, 2018

Nov 20, 2018

Form C/U filing

Gab AI filed the Form C/U at the date on Nov 20, 2018. At the close of the offering, the issuer closed on \$1,070,000 and 267,947 number of securities.

Reg CF Case

Gab AI Inc.

Funding history and Compliance with SEC

Gab AI, a social network that promotes free speech, has closed its recent crowdfunding campaign in November at the closed amount of \$1,067,287.85. Gab's team has a track record of success in fund-raising. On August 2017, Gab successfully raised \$ 1,069,485.10 amount from 1001 investors in the crowdfunding campaign, becoming the 7th company to break million dollars on StartEngine. Later, Gab AI start the Regulation A+ Security Token Offering crowdfunding approach and submitted the three rounds of comments from SEC during the Reg A+ campaign. As Gab's memorandum disclosed, Reg a+ offering cost 87,994. On September, one year after the first Reg CF offering, Gab announced that they planned to launch another Reg CF offering while waiting for the SEC to finish reviewing the Reg A+ campaign. Up to now, though it accumulated total amount of \$5,690,605.64 reservations from 1,850 investors under Reg A+, Gab AI still under the SEC review for its Title IV investments.

The Recent Reg CF STO disclosure

The purpose of the recent offering, a Reg CF campaign under the JOBS Act, is to issue the Class B common stock (Security Token) so as to attract more investors as shareholders as the part of Gab team. Reg CF offering and in connection with Rag A+ is aimed to widely market the Gab Platform, increase it's subscriber base and thereby increase its revenue. The crowdfunding campaign started on 09/19/2018 and closed on 11/18/2018 with total amount of 1,067,287.85 from 1890 investors. The cost associated with this offering is the accounting/audit fee of \$37,500, fees to the online portal StartEngine in total of \$64,037.27.

Financial Condition

Gab reflect a high-liquid and low-leverage financial condition. In 2017, Gab has \$637,291 in cash and no loans. Gab AI's revenue increased from \$0 to \$93,260 for the period from 12/31/2016 to 21/31/2017, and the cost of revenue increased from \$0 to \$49,834 in the same period. At the year ended 12/31/2017, Gab recognized a net loss of \$ 201,704 for the year, compared to net in come of \$ 11,087 last year, reflect net income margin of 19.2x. Also, Class B common stock issuance diluted the token price in the future. However, the current company value based on FCF reflect quote positive image, valued at \$38,857,564.

Risk of the Investment

Compared with ICO, the value of token derived from STO has a connection with companies' real-world performance. On one side, "Free speech" slogan and loyal customers accordingly have brought Gab AI a successful CF offering. On the other side, the political oriented system might be the most within the consideration. Up to now, Gab has been removed from Google Play Store for violating the company's hate speech policy, and also been rejected by Apple for similar reasons. Its account has been banned from Coinbase. Not to mention the accident exposed to the recent press on Oct. 27. One more unfortunately risk is associated with the subsequent resignation of Gab's chief technology officer. All these political sensitive factors may be harmful of the capital raising in near future, as well as bring back more difficulties for Gab AI to continually grow their business.

Reg CF Case

What you should learn from Gab's successful in Crowdfunding Gab AI Inc.

Offer more than just an idea

The fundamental factor that Gab's crowdfunding was so successful is because it offers more than just an idea. Gab knows their target audience well. Since from the inception, Gab team have relied on their donations from their existing platform users and the project founder. The Company's claims its network platform is committed to free speech and being politically neutral. This company attribute and culture attract growing number of users and investors who interested in their service, went quite popular among the social media industry.

In this Part I report, we made case studies for two practical security token offering, StartEngine STO and Gab AI STO. For case studies for Regulation D STO and Regulation S STO, please see Part II report.

To be continued...

about us

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