

# PUBLICATION

---

## The Hinman Standard: A Potential Path Forward in Token Offerings

January 22, 2019

**In a recent post on Medium, the Blockchain Association, a Washington, D.C.-based trade association for the blockchain industry, called on the Securities and Exchange Commission (the SEC) and Congress to adopt a clear regulatory framework for transactions involving digital tokens.**

The Blockchain Association suggested a framework, called the "Hinman Token Standard," which is based on a speech delivered by the director of the Division of Corporation Finance, William Hinman, on June 14, 2018 at the Yahoo Finance Markets Summit. In his remarks, Director Hinman said that digital tokens or coins may not be securities if the network on which they exist is "sufficiently decentralized." Applying this standard to Bitcoin and Ether, he concluded that neither digital coin qualified as a security because it existed on a network where no single actor or group maintained sufficient control over its success or failure.

Because of Director Hinman's analysis of Bitcoin and Ether, the Blockchain Association argued that tokens should not qualify as securities if they are located on a network at least as decentralized as Bitcoin's and Ether's networks were on June 14, 2018. The Blockchain Association applied the factors outlined in Director Hinman's speech to Bitcoin and Ether in order to demonstrate a threshold for satisfying the Hinman Token Standard. Based on this analysis, a network with some functionality, "distributed and open governance" and more users than speculators is decentralized enough to disqualify any tokens existing on the network from being a security.

Apart from Director Hinman's speech, the SEC has suggested through informal commentary and enforcement actions that most, if not all, tokens qualify as securities. The Commissioner of the SEC, Jay Clayton, even said in his testimony to Congress, "I believe every ICO I've seen is a security." Therefore, the SEC's informal guidance has trended toward the application of the federal securities laws to the offer and sale of digital tokens. This has caused most emerging companies interested in token offerings to either seek alternative methods of financing or undertake the cost of complying with, or finding an exemption to, the disclosure regime imposed by federal securities laws.

The Hinman Token Standard helps emerging companies understand a potential path for developing a network that falls outside the scope of federal securities laws. The Howey test is designed to ensure the application of federal securities laws to any transaction where investors expect to profit from the efforts of a central group of promoters. Given that test, it makes sense to focus on developing a functional network that is not dependent on a central group of leaders for its success or failure if emerging companies wish to avoid federal securities regulation. In a truly decentralized network, as the Blockchain Association and Director Hinman both indicated, information asymmetries will not exist between an inside group and investors, and the application of the disclosure regime under the federal securities laws to such a network will offer little benefit.

The Hinman Token Standard, however, is not a perfect standard, and start-up companies should not rely on it as an ultimate guide without performing a complete analysis under Section 2(a)(1) of the Securities Act of 1933, as amended. Further, neither Director Hinman nor the SEC has publicly applied the standard to any digital asset other than Bitcoin and Ether. Arguably, both of these digital coins existed on networks that were clearly decentralized, even though, as the Blockchain Association suggested, there was some concentration of

leadership in their development. As a result, it is difficult to use Bitcoin and Ether as a guide for tokens existing on networks that require more input from a core group of promoters.

Until the SEC or Congress issues more formal guidance regarding digital tokens, regulatory uncertainty will continue to affect the development and financing of blockchain networks. In the meantime, the Hinman Token Standard represents meaningful guidance for emerging companies to consider when creating their networks.

If you need assistance in determining whether the federal securities laws apply to your digital coins or tokens, please contact [Hunter Threet](#), or any member of Baker Donelson's [Corporate Finance and Securities Group](#).