Stage three: pre-launch fundraising

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SAFTs and token warrants

Most launches are preceded by private rounds in which investors pay now for tokens to be delivered later. The Simple Agreement for Future Tokens (SAFT) is a contract under which the investor pays a price and receives a right to tokens on the token generation event, at a discount to the public price. The token warrant is attached to an equity investment in the operating company and gives the investor the right to receive a proportion of the tokens allocated to the company or to the founders. Under FINMA's guidelines, the SAFT is itself an asset token if it is standardised and suitable for mass trading, because it is a claim to receive tokens. The issuer of such claims to more than a handful of investors is issuing securities.[1] The practical consequence is that SAFTs are drafted as bespoke, non-transferable agreements with individually negotiated terms, which takes them outside the securities definition under Art. 2 lit. b FinSA, and are offered only to professional clients or under the exemptions of Art. 36 FinSA.[2]

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In Singapore a SAFT is a contract for the future delivery of a token, and whether it is a capital markets product depends on whether the token is one. A SAFT for a utility token is an ordinary contract. A SAFT for a security token is an offer of a security and needs a prospectus unless an exemption applies. The exemptions are the small-offer exemption up to S$ 5 million in twelve months, the private placement to no more than fifty persons in twelve months and the offers to institutional and accredited investors.[3] Each exemption carries advertising restrictions, so the SAFT round cannot be marketed on social media even where no prospectus is needed.

The tax treatment of a SAFT is deferred until delivery. Switzerland treats the advance payment as a liability of the issuer until the tokens are delivered, at which point the issuer recognises revenue or, if the foundation is tax-exempt, nothing.[4] Singapore follows the same logic for a utility-token SAFT and treats the proceeds as income of the issuer when the tokens are delivered and the service obligation arises, with the possibility of spreading the income over the service period.[5]

Equity with token rights

Venture investors increasingly take equity in the operating company together with a token warrant. The structure gives them two exposures and the founders two sets of obligations. The warrant should state the proportion of tokens, the source (company allocation or founder allocation), the vesting, the lock-up and the treatment if the token is never launched. Two pitfalls recur. A warrant that gives the investor tokens from the foundation's allocation makes the foundation an issuer to the investor and undermines the foundation's independence. The tokens should come from the company's allocation. A warrant granted for no separate consideration is a derivative for Swiss purposes if it is standardised, so the same analysis as for SAFTs applies.

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Example

A Zug AG raises CHF 4 million from six venture funds at a CHF 20 million pre-money valuation. Each investor receives shares and a token warrant entitling it to a share of the AG's 15 per cent token allocation proportional to its equity stake, vesting over the same schedule as the team's tokens with a twelve-month cliff from the token generation event. The warrants are individually negotiated, non-transferable and offered to six professional clients, so no prospectus is required under FinSA and the warrants are outside the securities definition. The AG records the warrant as a contingent obligation. On the token generation event the AG delivers the tokens to the investors from its allocation and recognises no revenue because the consideration was received as equity. The investors hold tokens subject to lock-up. The Singapore subsidiary is not involved and no SFA question arises because the investors are in Europe.

Notes

1. FINMA, ICO Guidelines of 16 February 2018, section 3.2.1 (pre-financing and pre-sale: claims to acquire tokens treated as asset tokens, i.e. securities, if standardised and suitable for mass standardised trading). ↩
2. Financial Services Act of 15 June 2018 (FinSA; FIDLEG), SR 950.1, Art. 2 lit. b (securities: standardised certificated or uncertificated securities, derivatives and intermediated securities suitable for mass trading) and Art. 36 para. 1 (prospectus exemptions: professional clients; fewer than 500 investors; minimum of CHF 100,000 per investor; minimum denomination of CHF 100,000; total offer below CHF 8 million over twelve months). ↩
3. Securities and Futures Act 2001, ss. 272A (small personal offers: S$ 5 million in twelve months), 272B (private placement: no more than 50 persons in twelve months), 274 (institutional investors) and 275 (accredited investors and others; minimum consideration of S$ 200,000 under s. 275(1A)). Part K, Chapter IV. ↩

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4. FTA working paper on cryptocurrencies and ICOs/ITOs, section on the accounting treatment of advance payments for tokens (liability until delivery; revenue recognition on delivery). Part G, Chapter IV. ↩
5. IRAS e-Tax Guide, "Income Tax Treatment of Digital Tokens", section 9 (ICO proceeds; utility tokens as deferred revenue; security tokens as capital). ↩

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