

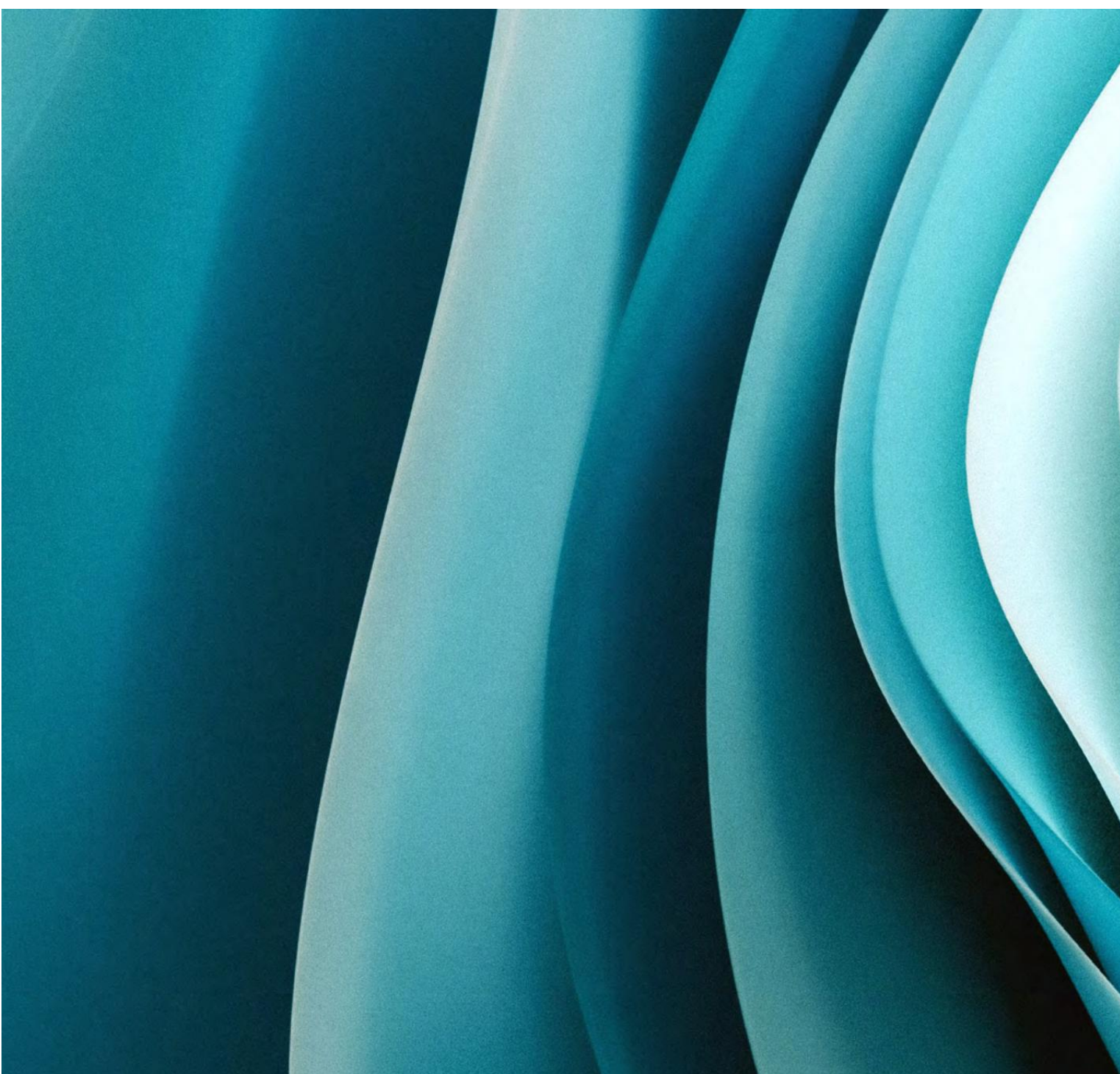
Advantages, Challenges and the Process of Tokenizing Funds

BLOCKCHAIN PRACTICE GROUP

Our firm is at the forefront of asset tokenization revolution

We advise clients from a wide variety of industries regarding the process of tokenizing different asset classes, including real estate, funds, operating businesses and luxury assets.

Our clients — blockchain startups, individual investors, funds, family offices, real estate owners/operators, art collectors, high net worth individuals and FinTech firms.



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Topics

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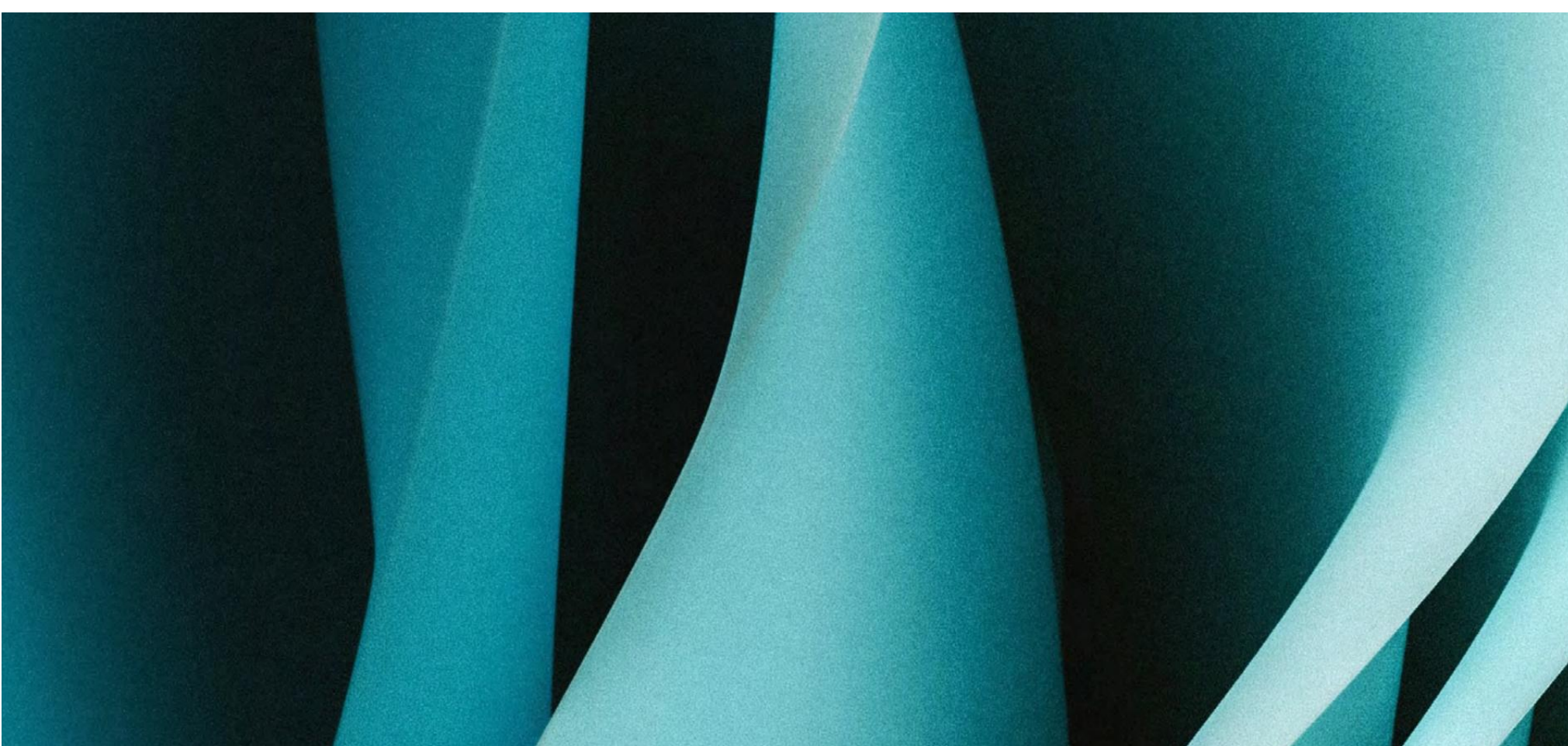
**Why tokenize
funds?**

2

**Key legal
considerations
for launching
a tokenized fund**

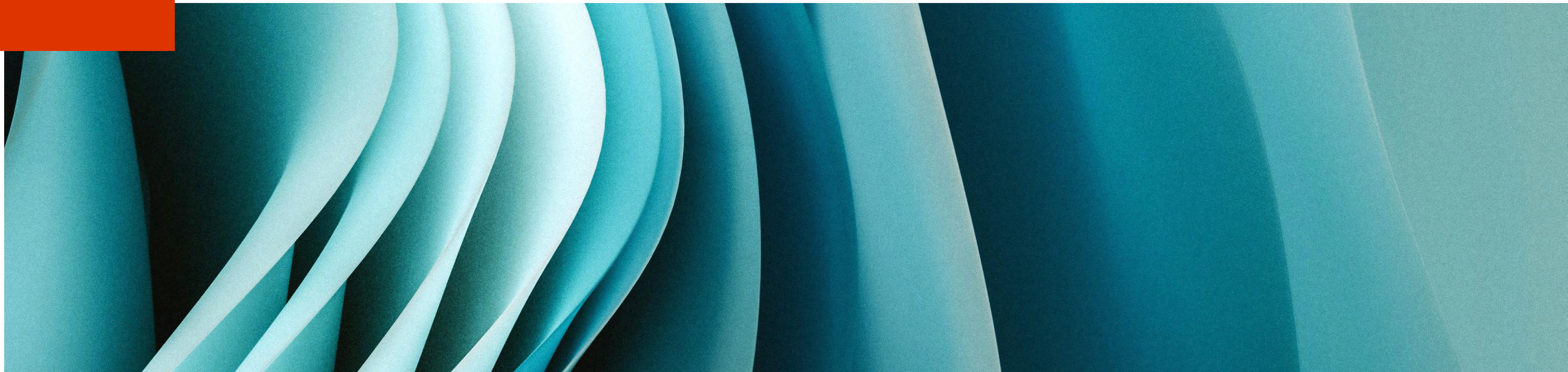
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**How to tokenize
a fund: practical
steps & cases**



Fund Tokenization

Process of creating a digital asset (token) to represent digital asset securities, i.e., tokenized limited partnership interest that can be traded 24/7 on regulated security token marketplaces in the US and abroad.



Types of Tokenized Funds

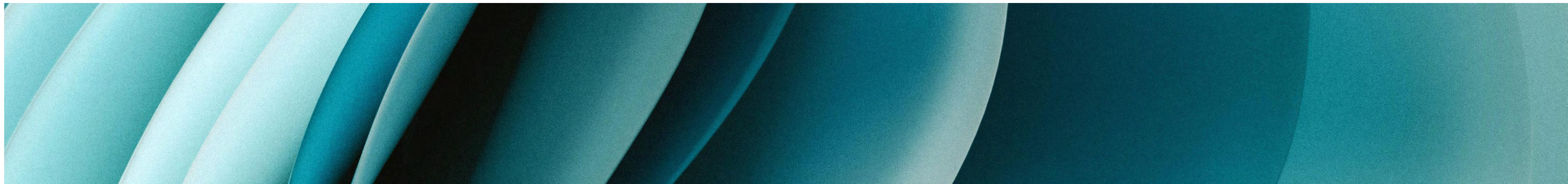
**Real Estate
Funds**

**Tokenized Art
Funds**

**Collectible Funds (Sneakers,
Classic Cars, Wine, Whiskey)**

**Biotech, Healthcare and
Life Science Funds**

**Precious Stone
Funds**



Why Tokenize Funds

1. Access to new demographics of individual investors globally.
2. Secondary market liquidity 24/7 for fund's tokenized LP shares on registered security token marketplaces (e.g., Securitize, tZero, Inx).
3. All operations, such as LP token issuance, investor subscription and redemption, are managed via blockchain smart-contracts, without any physical paperwork.
4. Automated blockchain compliance via smart contracts.
5. Simplified investor communications and cap table management.

Key Considerations: Regulations

U.S. Securities Regulations

- Registered vs. exempt offering.
- Accreditation.
- Secondary trading compliance and cap table restrictions.
- Necessary disclosures.

Broker-Dealer Regulations

- Marketing.
- Advisors.
- Finders.
- Team compensation.

Anti-Money Laundering Regulations

- KYC/AML checks.

Global Securities Regulations

Sale of Digital Securities in the US

General rule: you must register a security with the SEC before you can offer or sell it.

Consequence of selling unregistered securities: strict liability.

However: even if a token is a security, it may qualify for an exemption from registration.

As a practical matter, there is usually no need to register because you can almost always structure a STO to qualify for an exemption.

Most Commonly Used Exemptions

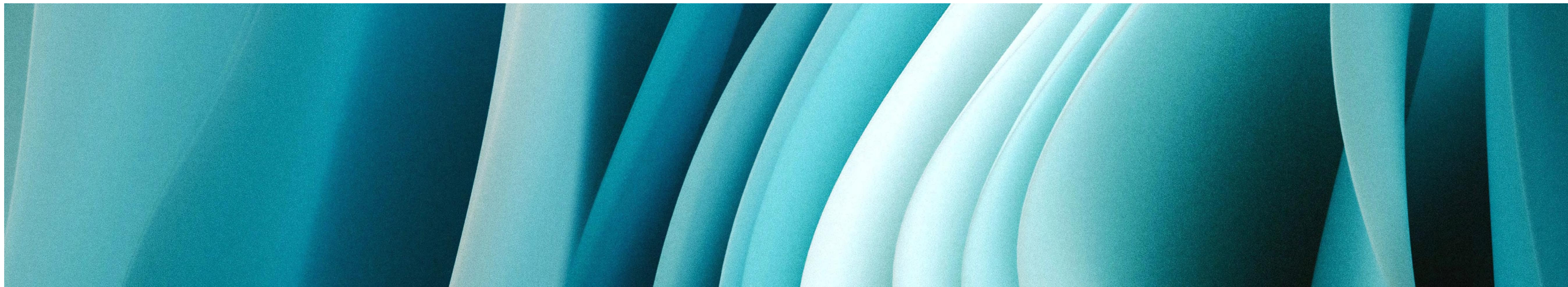
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506(c) under Reg. D + Reg. S

Section 3(c)(1) & Section 3(c)(7)

2

Section 3(c)(5) — real estate funds



Overview of Reg. D — Rule 506(c)

- No restrictions on advertising—general solicitation is permitted.
- No prospectus required (although issuers generally release a PPM).
- Issuers can raise an unlimited amount of funds.
- No financial reporting requirements for the issuer.
- Only accredited investors may participate in the sale.
- State securities laws are pre-empted (no need to seek registration or exemption on a state level).
- Purchasers cannot transfer their securities for one year (subject to certain exceptions).
- Form D must be filed with the SEC 15 days after the first sale.

Overview

Rule 901 says that offers and sales that occur outside the United States” don’t have to be registered.

Beware! The SEC has never clearly explained when an offer and sale occur outside the United States, so you shouldn’t rely on Rule 901 alone.

Fortunately, Rule 903 provides a safe harbor if an offer and sale satisfy the following requirements, they are deemed to occur outside the United States:

- Offer and sale made in an offshore transaction.
- No directed selling efforts are made in the United States.

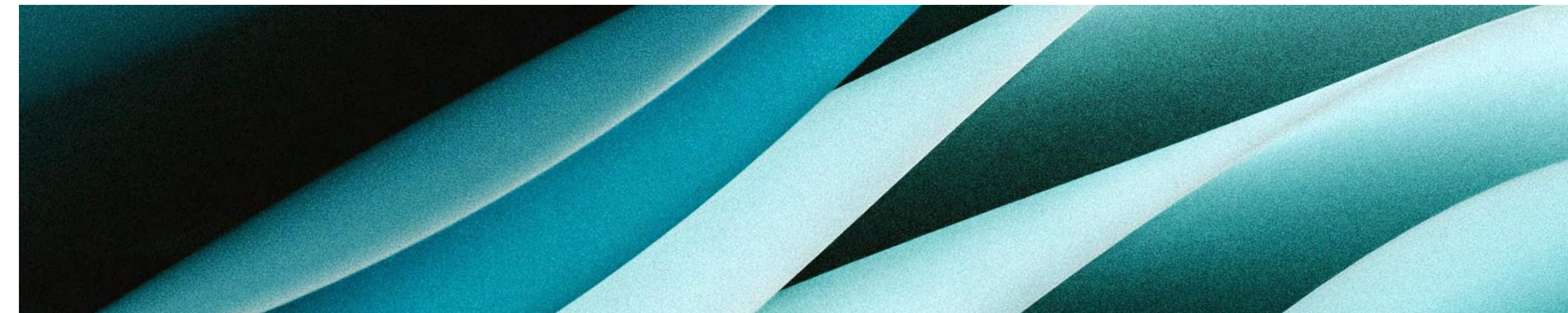
- Certain other requirements described in 903(b) are satisfied.

Overview of Section 3(c)(1)

- 3(c)(1) fund is a pooled investment vehicle that is excluded from the definition of investment company in the Investment Company Act.
- 3(c)(1) is limited to 100 investors and otherwise meets criteria outlined in the Investment Company Act.
- Typical private tokenized fund offers fund interests under Rule 506(c) and accepts investments from no more than 100 accredited investors.
- No restrictions on advertising — general solicitation is permitted.
- Fund's investment manager can claim SEC's exempt reporting advisor (ERA) exemption if the aggregate value of the assets of their private funds is less than \$150 million.
- ERAs must complete and file Form ADV with the SEC within sixty (60) days of the date on which the adviser commences the advisory relationship with its first private fund.

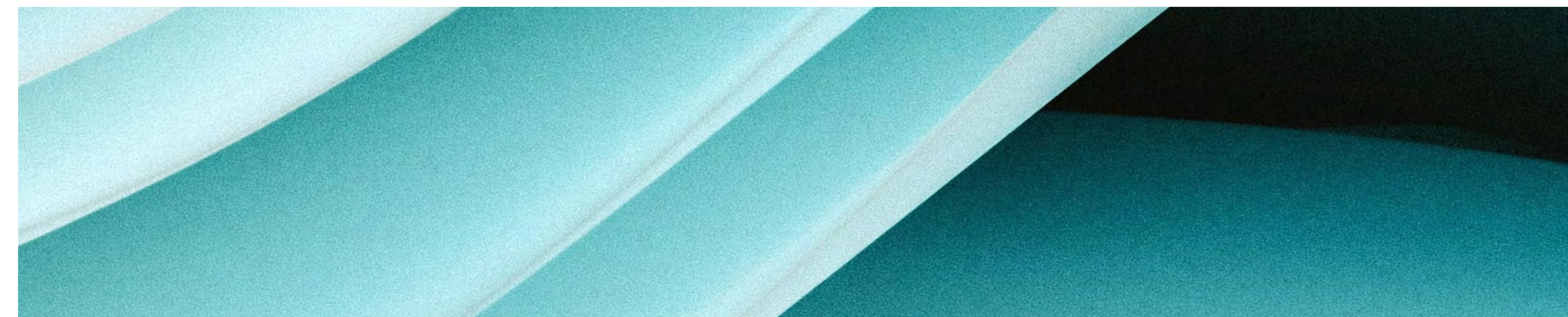
Overview of Section 3(c)(7)

- A 3(c)(7) fund is a pooled investment vehicle that is excluded from the definition of investment company in the Investment Company Act.
- A 3(c)(7) fund could take up to 2,000 investors before it is required to register with the SEC under the Securities and Exchange Act of 1934.
- Only “qualified purchasers” can participate in a 3(c)(7) fund.
- Term “qualified purchaser” is defined to include: any individual or family-owned business that owns \$5 million or more in investments; or a person, acting for his own account or the account of someone else, that owns and invests at least \$25 million in investments.



Overview of Section 3(c)(5)

- 3(c)(5) of the Act provides an exclusion from the definition of investment company act for any person that is primarily engaged in the business of purchasing interests in real estate.
- Exclusion in Section 3(c)(5) may be available to an issuer if: at least 45% of its assets consist primarily of “real estate-type interests”, and the remaining 55% of its assets consist of “mortgages and other liens on and interests in real estate” (called “qualifying interests”).
- Tokenized real estate funds offers fund interests under Rule 506(c) and accepts investments from no more than 2,000 accredited investors.



Additional Considerations

**Onshore v. offshore
fund structure**

**Open-end v. closed-end
structure**

**Currencies and crypto
accepted for the offering**

**Blockchain used for fund tokenization
(Avalanche, Ethereum, Algorand, etc.)**

**Offering price
per token**

**Number of
tokens offered**

**US and global tax
compliance**

**Multijurisdictional (multi-regimen)
treatment of tokens**

Stage 1: Preparation

What's involved? At a minimum

- Determination and implementation of the corporate structure, offering structure & token features.
- Preparation of a private placement memorandum, token purchase agreement/subscription agreement & necessary questionnaires.
- Contracting with fund administrator experienced in handling tokenized funds.
- Contracting with providers (tokenization platform, etc.).
- Whitelisting (advance AML/KYC/investor accreditation).
- Compliance with marketing restrictions
- Takes 6-8 weeks to launch 3(c)(1), 3(c)(5), 3(c)(7), Reg. D/S fund.

Offering Terms and Disclosures

- Company overview, projections, financials and risks.
- Rights attached to a token (e.g., common/preferred equity, distributions, profit-sharing, management/voting rights).
- Buyback/redemption rights.
- Transfer restrictions.
- Token price/soft cap/hard cap.
- Accepted currencies and conversion rates.
- Use of proceeds.
- Management team.

Stage 2: Token Sale

1

KYC/AML/
Accreditation.

2

Implementing
sales/returns/
burns transfer
restrictions on
smart contracts.

3

Collection
and custody
of crypto/fiat.

4

Issuance of tokens
(compliant with
regulations).

Stage 3: Life Cycle

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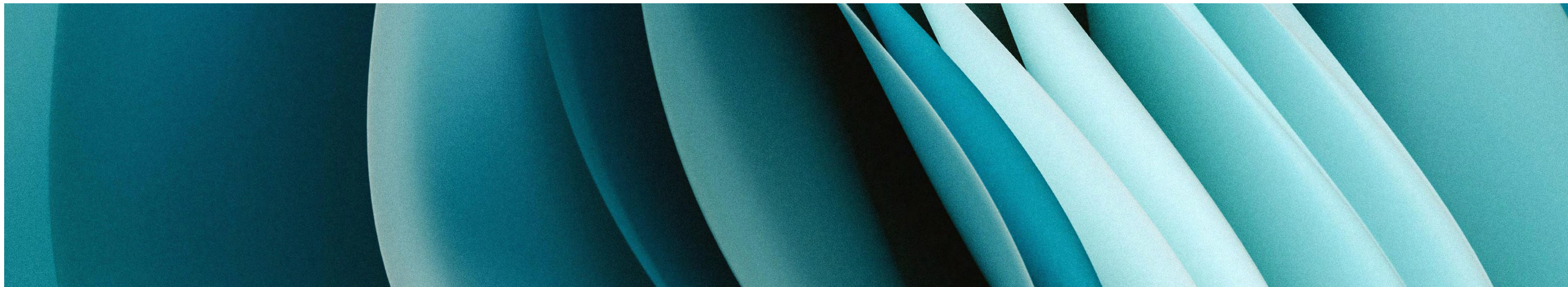
**Communications
with investors**

2

**Cap table
management**

3

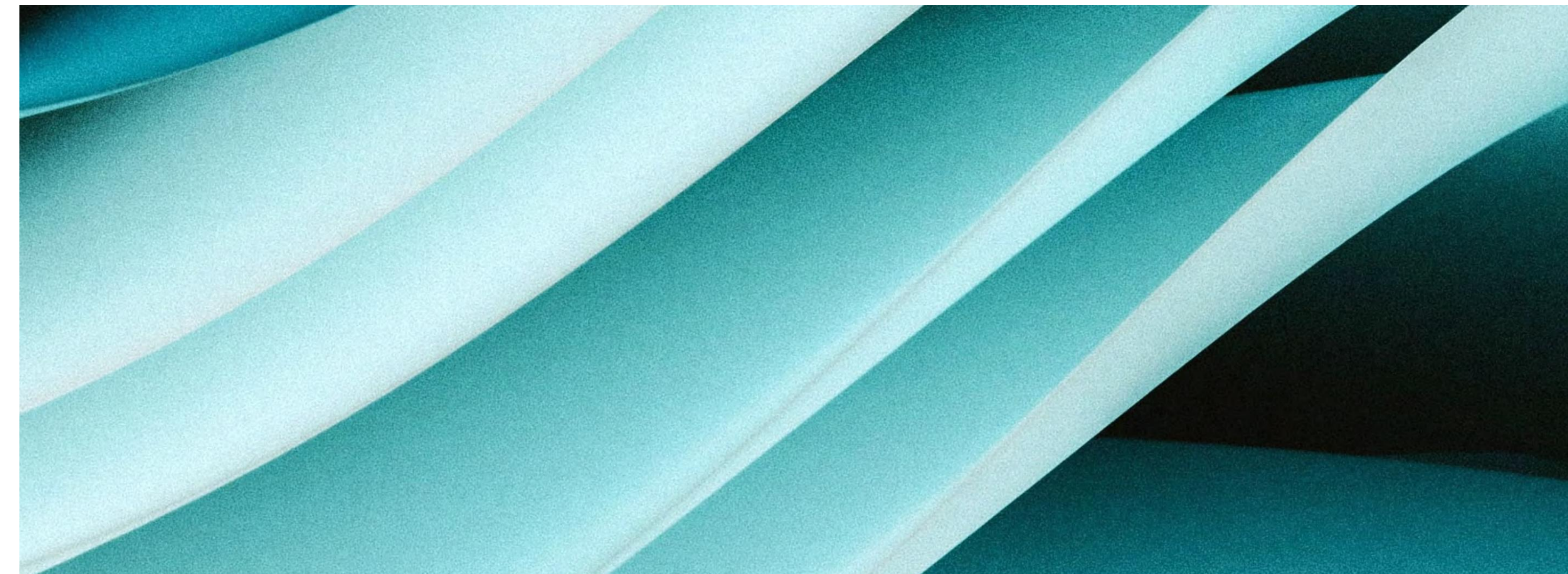
**Secondary trading
& anti-flowback**



Use Case

- 506(c) Regulation D Structure.
- Blockchain Used: Avalanche.
- Fund Jurisdiction: BVI.
- Fund Strategy: investing in medical devices, life science and pharmaceutical companies.
- Management Fee: 0.50%.

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Summary

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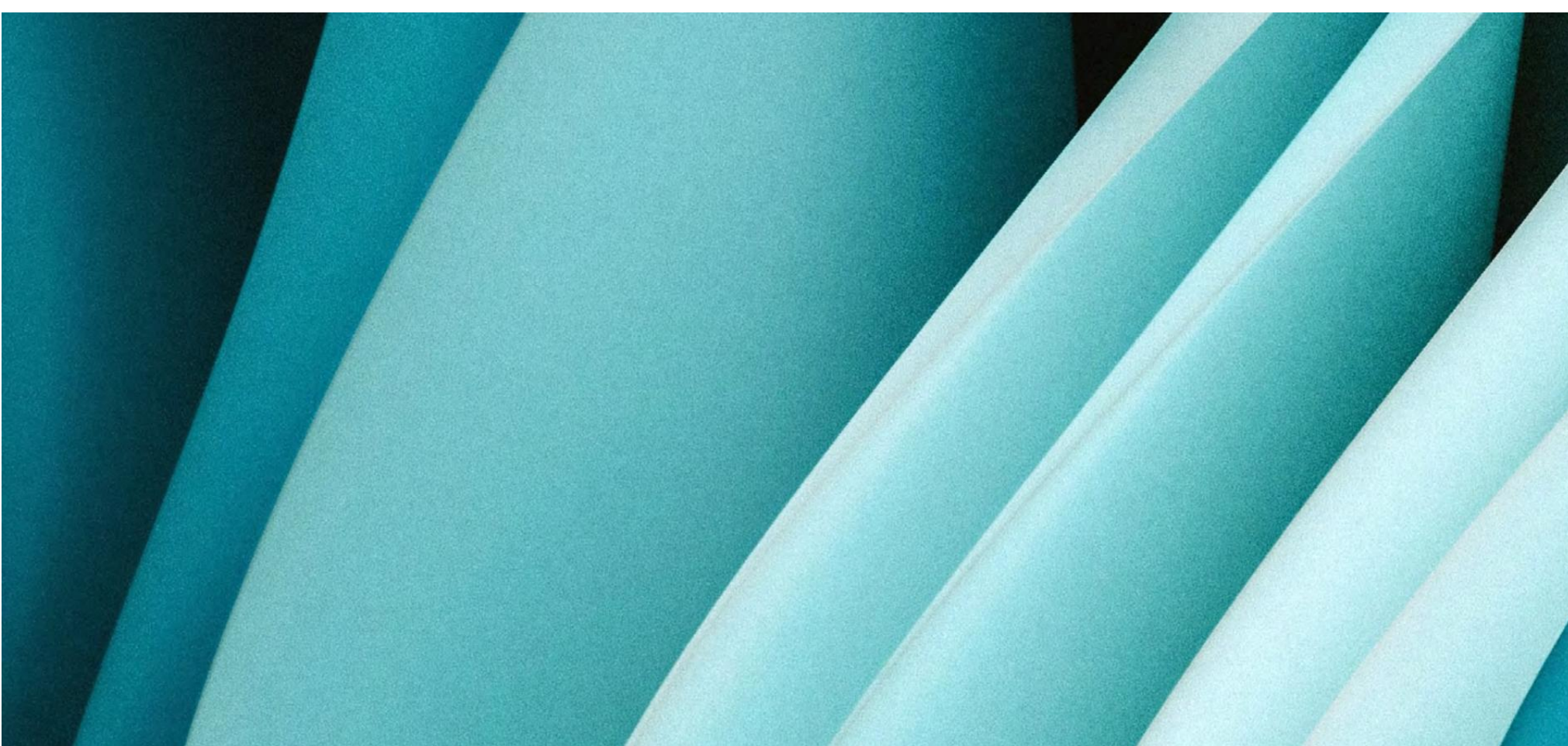
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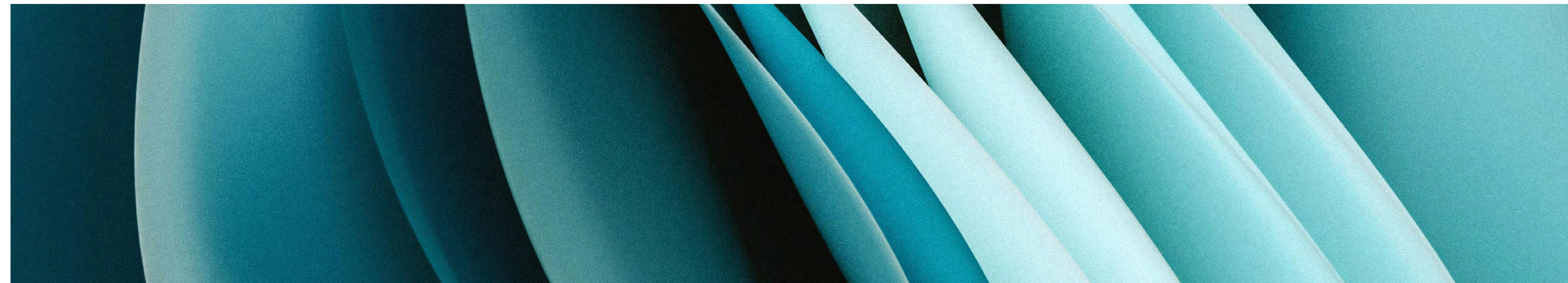


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