Legal Updates: Emerging-Growth Companies

Christopher S. Edwards
Reitler Kailas & Rosenblatt LLC
cedwards@reitlerlaw.com

Cryptocurrency Boom—and Bust?

- SEC's Office of Compliance Inspections and Examinations (OCIE):
  - Priorities for 2019 include a focus on digital tokens, cryptocurrencies, and coins, and the cryptocurrency market
  - Full report: https://www.sec.gov/files/OCIE%202019%20Priorities.pdf

Additional SEC Priorities for 2019

- Critical market infrastructure
- Cybersecurity
- Digital assets
- Anti-money laundering
- Retail investors

Tax Reform Effects Clearer

- Reductions in C-corporations' tax rates make C-corporations more popular
- Pass-through entities retain certain advantages
  - Deduction for qualifying income is sometimes available
  - Cap on deduction for state taxes reduces desirability of pass-through tax structure
- No clear right or wrong answer in all instances; careful examination of business and its long-term goals required

New Ways of Fundraising

- New SAFE (Simple Agreement for Future Equity; 2018 version) increasingly used
- KISS (Keep it Simple Security)
- SAFT (Simple Agreement for Future Tokens)

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Legal Updates for Emerging-Growth Companies and Funds that Invest in Them

Venture Capital Exemption:

- Rule 203(1)-1 of the Investment Advisers Act of 1940, as amended (“Advisers Act”)
- An investment adviser that advises only venture capital funds (“VCFs”) is exempt from registration under the Advisers Act

SEC's Definition of a Venture Capital Fund:

The SEC defines a VCF as a private fund that:

- Holds no more than 20% of the fund's capital commitments in non-qualifying investments
- Does not borrow or incur leverage in another capacity other than limited short-term borrowing
- Does not offer redemption rights to investors outside of unexpected circumstances (i.e., change in tax or other legal requirements)
- Represents itself as a VCF to investors and prospective investors
- Is not registered under the Investment Company Act of 1940, as amended, and is not treated as a business development company ("BDC") under section 54 of the same act

VCF Exclusions from Section 3(c)(1) of Advisers Act

Section 3(c)(1) of the Advisers Act was expanded on May 24, 2018, when the Economic Growth, Regulatory Relief and Consumer Protection Act (“Growth Act”) was signed into law. Section 504 of the Growth Act expands the exemption to include qualifying venture capital funds (“QVCFs”).

QVCFs are not deemed investment companies as long as the funds meet the following requirements:

- No more than 250 beneficial owners
- No more than $10MM in total capital contributions and uncalled committed capital
- Qualifies as a "venture capital fund” as defined under the “venture capital fund adviser” exemption under the Advisers Act
- Does not make a public offering of its securities

Qualifying Investments:

Qualifying investments are defined as:

- An equity security issued by a qualifying portfolio company that has been acquired directly by the private fund (from qualifying portfolio company)
- Any equity security issued by a qualifying portfolio company in exchange for an equity security issued by the qualifying portfolio company
- Any equity security issued by a company of which a qualifying portfolio company is a majority-owned subsidiary or a predecessor, and is acquired by the private fund in exchange for an equity security

Equity Security:

Equity security is defined as:

- Includes common stock, preferred stock, warrants and other securities convertible into common stock and limited partnership interests

Non-Qualifying Basket:

Investments that do not meet qualifying investment standards are considered part of a fund's non-qualifying basket.

- A fund must calculate the percent limit at the time it makes a non-qualifying acquisition; however, the fund it is not required to recalculate the percent limit if the acquired investment's value changes
- A fund DOES need to recalculate the total percentage of its capital commitments deemed "non-qualifying" each time it makes subsequent non-qualifying acquisitions
- If a fund holds more than 20% of its committed capital in non-qualifying investments, it must dispose of a portion of its non-qualifying investments to bring the fund back to the 20% limit
- A fund may use historical cost or fair value to determine the 20% limit so long as its methodology is consistent

Qualifying Portfolio Company:

A qualifying portfolio company has three requirements which are:

- Upon the fund making an investment, the company may not: (i) be a reporting company under the Securities Exchange Act of 1934, as amended the Exchange Act (“Exchange Act”); (ii) be listed or traded on any foreign exchange; and (iii) be an affiliate, either directly or indirectly, of an Exchange Act reporting company or a publicly traded foreign company
- The company may not borrow or issue debt obligations associated with the fund‘s investment and then distribute the proceeds to the fund in exchange for the private fund‘s investment (i.e. no leveraged buyouts)
- The company cannot be a private equity fund, VCF, hedge fund, commodity pool fund, mutual fund or an issuer of asset backed securities

Short-Term Holdings:

A short-term holding is considered an:

- Investment in cash and cash equivalents (e.g., bank deposits, CDs), US Treasury bonds with a maturity date of 60 days or less and shares of money market funds are permitted and do not count towards the 20% limit

Other Items re VCF and Applicable Requirements:

VCFs have certain limitations and requirements that must be satisfied to qualify for an exemption, such requirements and limitations include:

- A VCF can to continue to hold securities of a portfolio company that goes public as long as the investment was made prior to the company going public
- Leveraged buyout funds do not fall within the VCF exemption
- Leverage limitations: VCFs do not borrow funds, issue debt obligations, provide guarantees or incur leverage over 15% of the capital contributions and uncalled capital commitments.
- ANY permitted fund-level leveraged must be for a non-renewable period not longer than 120 days
- A non-U.S. adviser may rely on this exemption if its clients meet the definition of a VCF

Legal Updates for Emerging-Growth Companies and Funds that Invest in Them

Reporting Requirements and Other Rules:

VCFs and their advisers must adhere to the certain reporting requirements and other rules which include:

- The completion of certain sections of the Form ADV
- Pay-to-Play Rule
- Certain advisers who can rely on the VCF exemption may register with the SEC as long as such adviser has at least 100 million in AUM

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Legal Updates for Emerging-Growth Companies and Funds that Invest in Them

Q&A

Thank You for Joining

Fizza Khan

Chief Executive Officer
Silver Regulatory Associates
New York
+1 646.838.1718
fkhan@silverreg.com

A pioneer in providing outsourced compliance services to investment firms, Fizza Khan is an expert on regulations governing investment advisers, broker-dealers and registered and private funds. Through leadership positions at compliance consultancies, in-house legal counsel and compliance roles at various financial institutions and law firm practice, Fizza developed an approach for her clients that calibrates best practices with their business realities. Having personally handled numerous SEC examinations while in-house and as a consultant, Fizza knows how to satisfy regulator expectations without creating unmanageable complexity.

Prior to founding Silver Regulatory Associates, Fizza was the Chief Operating Officer for U.S. Compliance Consulting and a Managing Director at Duff & Phelps. She joined Duff & Phelps in January 2016 as a result of their acquisition of CounselWorks LLC where she was a Partner. At both Duff & Phelps and CounselWorks, Fizza managed the day-to-day provision of compliance services to the firm's clients and built the foundations upon which advice was given.

Fizza developed her insider perspective from her experience at a wide range of financial institutions. As senior counsel and the U.S. Chief Compliance Officer for DKR Oasis Management, a global private investment fund manager, Fizza was responsible for all U S. regulatory matters and supervision of domestic employees. As Chief Compliance Officer for the private fund business of Sandler O'Neill Advisors, a full service investment management, investment banking and brokerage firm, Fizza registered the firm with the SEC as an investment adviser, developed and oversaw its Advisers Act regulatory program and was responsible for the firm's FINRA compliance. She also successfully managed a number of formal SEC and FINRA regulatory examinations. As in-house counsel at Deutsche Banc, Fizza advised numerous registered and private fund managers as to fund and advisory entity structuring, prepared their SEC regulatory filings and, for the registered funds, performed analysis required by the Investment Company Act of 1940.

As an associate in the investment fund practice at Kramer Levin, Fizza specialized in the formation and management of registered and private funds.

Fizza received a Bachelor of Science in Business from Drexel University, where she concentrated on Finance and Economics and published a thesis on the effects of derivative trading regulation. She earned a law degree from the University of Maryland School of Law.

Supplemental Materials

Richard L. Chen

NATIONAL EXAM PROGRAM
RISK ALERT

By the Office of Compliance Inspections and Examinations[1]

Volume IV, Issue 2 **April 15, 2014**

Topic: Cybersecurity Examinations

Key Takeaways: OCIE will be conducting examinations of more than 50 registered broker-dealers and registered investment advisers, focusing on areas related to cybersecurity. In order to empower compliance professionals with questions and tools they can use to assess their respective firms' cybersecurity preparedness, OCIE has included a sample cybersecurity document request in the Appendix to this Risk Alert.

OCIE CYBERSECURITY INITIATIVE

I. Introduction

The U.S. Securities and Exchange Commission's Office of Compliance Inspections and Examinations (OCIE) previously announced that its 2014 Examination Priorities included a focus on technology, including cybersecurity preparedness.[2] OCIE is issuing this Risk Alert to provide additional information concerning its initiative to assess cybersecurity preparedness in the securities industry.

II. Background

On March 26, 2014, the SEC sponsored a Cybersecurity Roundtable. In opening the Roundtable, Chair Mary Jo White underscored the importance of this area to the integrity of our market system and customer data protection. Chair White also emphasized the "compelling need for stronger partnerships between the government and private sector" to address cyber threats.[3] Commissioner Aguilar, who recommended holding a Cybersecurity Roundtable, emphasized the importance for the Commission to gather information and "consider what additional steps the Commission should take to address cyber-threats."[4]

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1 The statements and views expressed herein are those of the staff of OCIE. This guidance is not a rule, regulation, or statement of the Commission. The Commission has expressed no view on its contents. This document was prepared by the SEC staff and is not legal advice.

2 Examination Priorities for 2014, *available at*: http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf.

3 Chair Mary Jo White, "Opening Statement at SEC Roundtable on Cybersecurity" (March 26, 2014), *available at*: http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370541286468.

4 Commissioner Luis A. Aguilar, "The Commission's Role in Addressing the Growing Cyber-Threat," Statement at SEC Roundtable on Cybersecurity (March 26, 2014), *available at*: http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370541287184.

III. Examinations

OCIE's cybersecurity initiative is designed to assess cybersecurity preparedness in the securities industry and to obtain information about the industry's recent experiences with certain types of cyber threats. As part of this initiative, OCIE will conduct examinations of more than 50 registered broker-dealers and registered investment advisers focused on the following: the entity's cybersecurity governance, identification and assessment of cybersecurity risks, protection of networks and information, risks associated with remote customer access and funds transfer requests, risks associated with vendors and other third parties, detection of unauthorized activity, and experiences with certain cybersecurity threats.

As part of OCIE's efforts to promote compliance and to share with the industry where it sees risk, OCIE is including, as the Appendix to this Risk Alert, a sample request for information and documents used in this initiative.

IV. Conclusion

These examinations will help identify areas where the Commission and the industry can work together to protect investors and our capital markets from cybersecurity threats. The sample document request (see Appendix) is intended to empower compliance professionals in the industry with questions and tools they can use to assess their firms' level of preparedness, regardless of whether they are included in OCIE's examinations.

This Risk Alert is intended to highlight for firms risks and issues that the staff has identified. In addition, this Risk Alert describes factors that firms may consider to (i) assess their supervisory, compliance and/or other risk management systems related to these risks, and (ii) make any changes, as may be appropriate, to address or strengthen such systems. These factors are not exhaustive, nor will they constitute a safe harbor. Other factors besides those described in this Risk Alert may be appropriate to consider, and some of the factors may not be applicable to a particular firm's business. While some of the factors discussed in this Risk Alert reflect existing regulatory requirements, they are not intended to alter such requirements. Moreover, future changes in laws or regulations may supersede some of the factors or issues raised here. The adequacy of supervisory, compliance, and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.

APPENDIX

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS
100 F STREET, NE
WASHINGTON, DC 20549

April 15, 2014

This document[1] provides a sample list of requests for information that the U.S. Securities and Exchange Commission's Office of Compliance Inspections and Examinations (OCIE) may use in conducting examinations of registered entities regarding cybersecurity matters. Some of the questions track information outlined in the "Framework for Improving Critical Infrastructure Cybersecurity,"[2] released on February 12, 2014 by the National Institute of Standards and Technology. OCIE has published this document as a resource for registered entities. This document should not be considered all inclusive of the information that OCIE may request. Accordingly, OCIE will alter its requests for information as it considers the specific circumstances presented by each firm's particular systems or information technology environment.

Identification of Risks/Cybersecurity Governance

1. For each of the following practices employed by the Firm for management of information security assets, please provide the month and year in which the noted action was last taken; the frequency with which such practices are conducted; the group with responsibility for conducting the practice; and, if not conducted firmwide, the areas that are included within the practice. Please also provide a copy of any relevant policies and procedures.

    - Physical devices and systems within the Firm are inventoried.
    - Software platforms and applications within the Firm are inventoried.
    - Maps of network resources, connections, and data flows (including locations where customer data is housed) are created or updated.
    - Connections to the Firm's network from external sources are catalogued.
    - Resources (hardware, data, and software) are prioritized for protection based on their sensitivity and business value.
    - Logging capabilities and practices are assessed for adequacy, appropriate retention, and secure maintenance.

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2 National Institute of Standards and Technology, "Framework for Improving Critical Infrastructure Cybersecurity," (Feb. 12, 2014), *available at*: http://www.nist.gov/cyberframework/upload/cybersecurity-framework-021214-final.pdf.

2. Please provide a copy of the Firm's written information security policy.

3. Please indicate whether the Firm conducts periodic risk assessments to identify cybersecurity threats, vulnerabilities, and potential business consequences. If such assessments are conducted:

    a. Who (business group/title) conducts them, and in what month and year was the most recent assessment completed?

    b. Please describe any findings from the most recent risk assessment that were deemed to be potentially moderate or high risk and have not yet been fully remediated.

4. Please indicate whether the Firm conducts periodic risk assessments to identify physical security threats and vulnerabilities that may bear on cybersecurity. If such assessments are conducted:

    a. Who (business group/title) conducts them, and in what month and year was the most recent assessment completed?

    b. Please describe any findings from the most recent risk assessment that were deemed to be potentially moderate or high risk and have not yet been fully remediated.

5. If cybersecurity roles and responsibilities for the Firm's workforce and managers have been explicitly assigned and communicated, please provide written documentation of these roles and responsibilities. If no written documentation exists, please provide a brief description.

6. Please provide a copy of the Firm's written business continuity of operations plan that addresses mitigation of the effects of a cybersecurity incident and/or recovery from such an incident if one exists.

7. Does the Firm have a Chief Information Security Officer or equivalent position? If so, please identify the person and title. If not, where does principal responsibility for overseeing cybersecurity reside within the Firm?

8. Does the Firm maintain insurance that specifically covers losses and expenses attributable to cybersecurity incidents? If so, please briefly describe the nature of the coverage and indicate whether the Firm has filed any claims, as well as the nature of the resolution of those claims.

Protection of Firm Networks and Information

9. Please identify any published cybersecurity risk management process standards, such as those issued by the National Institute of Standards and Technology (NIST) or the International Organization for Standardization (ISO), the Firm has used to model its information security architecture and processes.

10. Please indicate which of the following practices and controls regarding the protection of its networks and information are utilized by the Firm, and provide any relevant policies and procedures for each item.

- The Firm provides written guidance and periodic training to employees concerning information security risks and responsibilities. If the Firm provides such guidance and/or training, please provide a copy of any related written materials (*e.g.*, presentations) and identify the dates, topics, and which groups of employees participated in each training event conducted since January 1, 2013.

- The Firm maintains controls to prevent unauthorized escalation of user privileges and lateral movement among network resources. If so, please describe the controls, unless fully described within policies and procedures.

- The Firm restricts users to those network resources necessary for their business functions. If so, please describe those controls, unless fully described within policies and procedures.

- The Firm maintains an environment for testing and development of software and applications that is separate from its business environment.

- The Firm maintains a baseline configuration of hardware and software, and users are prevented from altering that environment without authorization and an assessment of security implications.

- The Firm has a process to manage IT assets through removal, transfers, and disposition.

- The Firm has a process for ensuring regular system maintenance, including timely installation of software patches that address security vulnerabilities.

- The Firm's information security policy and training address removable and mobile media.

- The Firm maintains controls to secure removable and portable media against malware and data leakage. If so, please briefly describe these controls.

- The Firm maintains protection against Distributed Denial of Service (DDoS) attacks for critical internet-facing IP addresses. If so, please describe the internet functions protected and who provides this protection.

- The Firm maintains a written data destruction policy.

- The Firm maintains a written cybersecurity incident response policy. If so, please provide a copy of the policy and indicate the year in which it was most recently updated. Please also indicate whether the Firm conducts tests or exercises to assess its incident response policy, and if so, when and by whom the last such test or assessment was conducted.

- The Firm periodically tests the functionality of its backup system. If so, please provide the month and year in which the backup system was most recently tested.

11. Please indicate whether the Firm makes use of encryption. If so, what categories of data, communications, and devices are encrypted and under what circumstances?

12. Please indicate whether the Firm conducts periodic audits of compliance with its information security policies. If so, in what month and year was the most recent such audit completed, and by whom was it conducted?

Risks Associated With Remote Customer Access and Funds Transfer Requests

13. Please indicate whether the Firm provides customers with on-line account access. If so, please provide the following information:

    a. The name of any third party or parties that manage the service.

    b. The functionality for customers on the platform (*e.g.*, balance inquiries, address and contact information changes, beneficiary changes, transfers among the customer's accounts, withdrawals or other external transfers of funds).

    c. How customers are authenticated for on-line account access and transactions.

    d. Any software or other practice employed for detecting anomalous transaction requests that may be the result of compromised customer account access.

    e. A description of any security measures used to protect customer PINs stored on the sites.

    f. Any information given to customers about reducing cybersecurity risks in conducting transactions/business with the Firm.

14. Please provide a copy of the Firm's procedures for verifying the authenticity of email requests seeking to transfer customer funds. If no written procedures exist, please describe the process.

15. Please provide a copy of any Firm policies for addressing responsibility for losses associated with attacks or intrusions impacting customers.

    a. Does the Firm offer its customers a security guarantee to protect them against hacking of their accounts? If so, please provide a copy of the guarantee if one exists and a brief description.

Risks Associated With Vendors and Other Third Parties

16. If the Firm conducts or requires cybersecurity risk assessments of vendors and business partners with access to the Firm's networks, customer data, or other sensitive information, or due to the cybersecurity risk of the outsourced function, please describe who conducts this assessment, when it is required, and how it is conducted. If a questionnaire is used, please provide a copy. If assessments by independent entities are required, please describe any standards established for such assessments.

17. If the Firm regularly incorporates requirements relating to cybersecurity risk into its contracts with vendors and business partners, please describe these requirements and the circumstances in which they are incorporated. Please provide a sample copy.

18. Please provide a copy of policies and procedures and any training materials related to information security procedures and responsibilities for trainings conducted since January 2013 for vendors and business partners authorized to access its network.

19. If the Firm assesses the segregation of sensitive network resources from resources accessible to third parties, who (business group/title) performs this assessment, and provide a copy of any relevant policies and procedures?

20. If vendors, business partners, or other third parties may conduct remote maintenance of the Firm's networks and devices, describe any approval process, logging process, or controls to prevent unauthorized access, and provide a copy of any relevant policies and procedures.

Detection of Unauthorized Activity

21. For each of the following practices employed by the Firm to assist in detecting unauthorized activity on its networks and devices, please briefly explain how and by whom (title, department and job function) the practice is carried out.

- Identifying and assigning specific responsibilities, by job function, for detecting and reporting suspected unauthorized activity.
- Maintaining baseline information about expected events on the Firm's network.
- Aggregating and correlating event data from multiple sources.
- Establishing written incident alert thresholds.
- Monitoring the Firm's network environment to detect potential cybersecurity events.
- Monitoring the Firm's physical environment to detect potential cybersecurity events.
- Using software to detect malicious code on Firm networks and mobile devices.
- Monitoring the activity of third party service providers with access to the Firm's networks.
- Monitoring for the presence of unauthorized users, devices, connections, and software on the Firm's networks.
- Evaluating remotely-initiated requests for transfers of customer assets to identify anomalous and potentially fraudulent requests.

- Using data loss prevention software.

- Conducting penetration tests and vulnerability scans. If so, please identify the month and year of the most recent penetration test and recent vulnerability scan, whether they were conducted by Firm employees or third parties, and describe any findings from the most recent risk test and/or assessment that were deemed to be potentially moderate or high risk but have not yet been addressed.

- Testing the reliability of event detection processes. If so, please identify the month and year of the most recent test.

- Using the analysis of events to improve the Firm's defensive measures and policies.

Other

22. Did the Firm update its written supervisory procedures to reflect the Identity Theft Red Flags Rules, which became effective in 2013 (17 CFR § 248—Subpart C—Regulation S-ID)?

    a. If not, why?

23. How does the Firm identify relevant best practices regarding cybersecurity for its business model?

24. **Since January 1, 2013**, has your Firm experienced any of the following types of events? If so, please provide a brief summary for each category listed below, identifying the number of such incidents (approximations are acceptable when precise numbers are not readily available) and describing their significance and any effects on the Firm, its customers, and its vendors or affiliates. If the response to any one item includes more than 10 incidents, the respondent may note the number of incidents and describe incidents that resulted in losses of more than $5,000, the unauthorized access to customer information, or the unavailability of a Firm service for more than 10 minutes. The record or description should, at a minimum, include: the extent to which losses were incurred, customer information accessed, and Firm services impacted; the date of the incident; the date the incident was discovered and the remediation for such incident.

    - Malware was detected on one or more Firm devices. Please identify or describe the malware.

    - Access to a Firm web site or network resource was blocked or impaired by a denial of service attack. Please identify the service affected, and the nature and length of the impairment.

    - The availability of a critical Firm web or network resource was impaired by a software or hardware malfunction. Please identify the service affected, the nature and length of the impairment, and the cause.

    - The Firm's network was breached by an unauthorized user. Please describe the nature, duration, and consequences of the breach, how the Firm learned of it, and how it was remediated.

- The compromise of a customer's or vendor's computer used to remotely access the Firm's network resulted in fraudulent activity, such as efforts to fraudulently transfer funds from a customer account or the submission of fraudulent payment requests purportedly on behalf of a vendor.

- The Firm received fraudulent emails, purportedly from customers, seeking to direct transfers of customer funds or securities.

- The Firm was the subject of an extortion attempt by an individual or group threatening to impair access to or damage the Firm's data, devices, network, or web services.

- An employee or other authorized user of the Firm's network engaged in misconduct resulting in the misappropriation of funds, securities, sensitive customer or Firm information, or damage to the Firm's network or data.

25. **Since January 1, 2013**, if not otherwise reported above, did the Firm, either directly or as a result of an incident involving a vendor, experience the theft, loss, unauthorized exposure, or unauthorized use of or access to customer information? Please respond affirmatively even if such an incident resulted from an accident or negligence, rather than deliberate wrongdoing. If so, please provide a brief summary of each incident or a record describing each incident.

26. For each event identified in response to Questions 24 and 25 above, please indicate whether it was reported to the following:

    - Law enforcement (please identify the entity)

    - FinCEN (through the filing of a Suspicious Activity Report)

    - FINRA

    - A state or federal regulatory agency (please identity the agency and explain the manner of reporting)

    - An industry or public-private organization facilitating the exchange of information about cybersecurity incidents and risks

27. What does the Firm presently consider to be its three most serious cybersecurity risks, and why?

28. Please feel free to provide any other information you believe would be helpful to the Securities and Exchange Commission in evaluating the cybersecurity posture of the Firm or the securities industry.

NATIONAL EXAM PROGRAM
RISK ALERT

By the Office of Compliance Inspections and Examinations ("OCIE")[1]

Volume VI, Issue 5 **August 7, 2017**

This Risk Alert provides a summary of observations from OCIE's examinations of registered broker-dealers, investment advisers, and investment companies conducted pursuant to the Cybersecurity Examination Initiative announced on September 15, 2015.

OBSERVATIONS FROM CYBERSECURITY EXAMINATIONS

I. Introduction

In OCIE's Cybersecurity 2 Initiative, National Examination Program staff examined 75 firms, including broker-dealers, investment advisers, and investment companies ("funds") registered with the SEC to assess industry practices and legal and compliance issues associated with cybersecurity preparedness.[2] The Cybersecurity 2 Initiative built upon prior cybersecurity examinations, particularly OCIE's 2014 Cybersecurity 1 Initiative.[3] However, the Cybersecurity 2 Initiative examinations involved more validation and testing of procedures and controls surrounding cybersecurity preparedness than was previously performed.

The examinations focused on the firms' written policies and procedures regarding cybersecurity, including validating and testing that such policies and procedures were implemented and followed. In addition, the staff sought to better understand how firms managed their cybersecurity preparedness by focusing on the following areas: (1) governance and risk assessment; (2) access rights and controls; (3) data loss prevention; (4) vendor management; (5) training; and (6) incident response.

In general, the staff observed increased cybersecurity preparedness since our 2014 Cybersecurity 1 Initiative. However, the staff also observed areas where compliance and oversight could be improved. This Risk Alert provides a summary of the staff's observations from the Cybersecurity 2 Initiative

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1 The views expressed herein are those of the staff of OCIE, in coordination with other staff of the Securities and Exchange Commission ("SEC" or "Commission"). The Commission has expressed no view on the contents of this Risk Alert. This document was prepared by the SEC staff and is not legal advice.

2 *See* OCIE, *Examination Priorities for 2015* (January 13, 2015) and *National Exam Program Risk Alert, OCIE's 2015 Cybersecurity Examination Initiative* (September 15, 2015). A few of the staff's observations discussed herein were previously discussed in a recent *National Exam Program Risk Alert, Cybersecurity: Ransomware Alert* (May 17, 2017).

3 *See* OCIE, *OCIE Cybersecurity Initiative* (April 15, 2014) and *National Exam Program Risk Alert, Cybersecurity Examination Sweep Summary* (February 3, 2015). The staff examined a different population of firms in the Cybersecurity 2 Initiative than those that were examined in the Cybersecurity 1 Initiative.

examinations and highlights certain issues observed as well as certain policies and procedures that the staff believes may be effective.[4]

II. Summary of Examination Observations

Among the 75 firms examined, the staff noted an overall improvement in firms' awareness of cyber-related risks and the implementation of certain cybersecurity practices since the Cybersecurity 1 Initiative. Most notably, all broker-dealers, all funds, and nearly all advisers examined maintained cybersecurity-related written policies and procedures addressing the protection of customer/shareholder records and information. This contrasts with the staff's observations in the Cybersecurity 1 Initiative, in which comparatively fewer broker-dealers and advisers had adopted this type of written policies and procedures.

In the examinations, the staff observed:

- Nearly all broker-dealers and the vast majority of advisers and funds conducted periodic risk assessments of critical systems to identify cybersecurity threats, vulnerabilities, and the potential business consequences of a cyber incident.

- Nearly all broker-dealers and almost half of the advisers and funds conducted penetration tests and vulnerability scans on systems that the firms considered to be critical, although a number of firms did not appear to fully remediate some of the high risk observations that they discovered from these tests and scans during the review period.

- All firms utilized some form of system, utility, or tool to prevent, detect, and monitor data loss as it relates to personally identifiable information.

- All broker-dealers and nearly all advisers and funds had a process in place for ensuring regular system maintenance, including the installation of software patches to address security vulnerabilities. However, the staff observed that a few of the firms had a significant number of system patches that, according to the firms, included critical security updates that had not yet been installed.

- Information protection programs at the firms typically included relevant cyber-related topics, such as:

    - *Policies and procedures*. Nearly all firms' policies and procedures addressed cyber-related business continuity planning and Regulation S-P.[5] In addition, nearly all broker-dealers and

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[4] The examinations were conducted between September 2015 and June 2016 and generally covered the review period October 1, 2014 through September 30, 2015.

[5] *See* 17 C.F.R. Part 248, Subpart A—*Regulation S–P: Privacy of Consumer Financial Information and Safeguarding Personal Information*. *See also Disposal of Consumer Report Information*, Securities Exchange Act of 1934 ("Exchange Act") Release No. 50781, Investment Advisers Act of 1940 ("Advisers Act") Release No. 2332, Investment Company Act of 1940 ("Investment Company Act") Release No. 26685 (December 2, 2004), 69 Fed. Reg. 71321 (December 8, 2004) and *Privacy of Consumer Financial Information (Regulation S-P)*, Exchange Act Release No. 42974, Investment Company Act Release No. 24543, Advisers Act Release No. 1883 (June 22, 2000), 65 Fed. Reg. 40334 (June 29, 2000).

most advisers and funds had specific cybersecurity and Regulation S-ID[6] policies and procedures.

- *Response plans.* Nearly all of the firms had plans for addressing access incidents. In addition, the vast majority of firms had plans for denial of service incidents and unauthorized intrusions. However, while the vast majority of broker-dealers maintained plans for data breach incidents and most had plans for notifying customers of material events, less than two-thirds of the advisers and funds appeared to maintain such plans.

- All broker-dealers and a large majority of advisers and funds maintained cybersecurity organizational charts and/or identified and described cybersecurity roles and responsibilities for the firms' workforce.

- The vast majority of broker-dealers and nearly two-thirds of the advisers and funds had authority from customers/shareholders to transfer funds to third party accounts.

  - Some of the broker-dealers did not appear to memorialize their processes into written supervisory procedures. Rather, these broker-dealers appeared to have informal practices for verifying customers' identities in order to proceed with requests to transfer funds.

  - All of the advisers and funds maintained policies, procedures, and standards related to verifying the authenticity of a customer/shareholder who was requesting to transfer funds.

- Almost all firms either conducted vendor risk assessments or required that vendors provide the firms with risk management and performance reports (i.e., internal and/or external audit reports) and security reviews or certification reports. While vendor risk assessments are typically conducted at the outset of a relationship, over half of the firms also required updating such risk assessments on at least an annual basis.

III. Issues Observed

The staff observed one or more issues in the vast majority of the Cybersecurity 2 Initiative examinations. Highlighted below are issues the staff believes firms would benefit from considering in order to assess and improve their policies, procedures, and practices.

- While, as noted above, all broker-dealers and funds, and nearly all advisers maintained written policies and procedures addressing cyber-related protection of customer/shareholder records and information, a majority of the firms' information protection policies and procedures appeared to have issues. Examples included:

  - *Policies and procedures were not reasonably tailored* because they provided employees with only general guidance, identified limited examples of safeguards for employees to consider, were very narrowly scoped, or were vague, as they did not articulate procedures for implementing the policies.

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[6] *See* 17 C.F.R. Part 248, Subpart C—*Regulation S-ID: Identity Theft Red Flags*. *See also Identity Theft Red Flags Rules*, Exchange Act Release No. 69359, Advisers Act Release No. 3582, Investment Company Act Release No. 30456 (April 10, 2013), 78 Fed. Reg. 23637 (April 19, 2013).

- *Firms did not appear to adhere to or enforce policies and procedures, or the policies and procedures did not reflect the firms' actual practices*, such as when the policies:
    - Required annual customer protection reviews; however, in practice, they were conducted less frequently.
    - Required ongoing reviews to determine whether supplemental security protocols were appropriate; however, such reviews were performed only annually, or not at all.
    - Created contradictory or confusing instructions for employees, such as policies regarding remote customer access that appeared to be inconsistent with those for investor fund transfers, making it unclear to employees whether certain activity was permissible.
    - Required all employees to complete cybersecurity awareness training; however, firms did not appear to ensure this occurred and take action concerning employees who did not complete the required training.

- The staff also observed Regulation S-P-related issues among firms that did not appear to adequately conduct system maintenance, such as the installation of software patches to address security vulnerabilities and other operational safeguards to protect customer records and information. Examples included:
    - *Stale Risk Assessments*. Using outdated operating systems that were no longer supported by security patches.
    - *Lack of Remediation Efforts*. High-risk findings from penetration tests or vulnerability scans that did not appear to be fully remediated in a timely manner.

IV. Elements of Robust Policies and Procedures[7]

During these examinations, the staff observed several elements that were included in the policies and procedures of firms that the staff believes had implemented robust controls. Firms may wish to consider the following elements as they could be useful in the implementation of cybersecurity-related policies and procedures.[8]

- *Maintenance of an inventory of data, information, and vendors*. Policies and procedures included a complete inventory of data and information, along with classifications of the risks,

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[7] This is not intended to be a comprehensive list of the elements of robust cybersecurity policies and procedures. The adequacy of supervisory, compliance, and other risk management policies and procedures can be determined only with reference to the profile of each specific firm and other facts and circumstances.

[8] Firms may also wish to consider the guidance and information issued by the SEC's Division of Investment Management and the cybersecurity issues discussed in Commission orders in settled enforcement proceedings. *See, e.g.*, *IM Guidance Update: Cybersecurity Guidance* (April 2015), *In re Morgan Stanley Smith Barney LLC*, Exchange Act Release No. 78021, Advisers Act Release No. 4415 (June 8, 2016), *In re R.T. Jones Capital Equities Management Inc.*, Advisers Act Release No. 4204 (September 22, 2015), and *In re Craig Scott Capital LLC*, Exchange Act Release No. 77595 (April 12, 2016).

vulnerabilities, data, business consequences, and information regarding each service provider and vendor, if applicable.

- *Detailed cybersecurity-related instructions*. Examples included:
  - Penetration tests – policies and procedures included specific information to review the effectiveness of security solutions.
  - Security monitoring and system auditing – policies and procedures regarding the firm's information security framework included details related to the appropriate testing methodologies.
  - Access rights – requests for access were tracked, and policies and procedures specifically addressed modification of access rights, such as for employee on-boarding, changing positions or responsibilities, or terminating employment.
  - Reporting – policies and procedures specified actions to undertake, including who to contact, if sensitive information was lost, stolen, or unintentionally disclosed/misdirected.
- *Maintenance of prescriptive schedules and processes for testing data integrity and vulnerabilities*. Examples included:
  - Vulnerability scans of core IT infrastructure were required to aid in identifying potential weaknesses in a firm's key systems, with prioritized action items for any concerns identified.
  - Patch management policies that included, among other things, the beta testing of a patch with a small number of users and servers before deploying it across the firm, an analysis of the problem the patch was designed to fix, the potential risk in applying the patch, and the method to use in applying the patch.
- *Established and enforced controls to access data and systems*. For example, the firms:
  - Implemented detailed "acceptable use" policies that specified employees' obligations when using the firm's networks and equipment.
  - Required and enforced restrictions and controls for mobile devices that connected to the firms' systems, such as passwords and software that encrypted communications.
  - Required third-party vendors to periodically provide logs of their activity on the firms' networks.
  - Required immediate termination of access for terminated employees and very prompt (typically same day) termination of access for employees that left voluntarily.
- *Mandatory employee training*. Information security training was mandatory for all employees at on-boarding and periodically thereafter, and firms instituted policies and procedures to ensure that employees completed the mandatory training.
- *Engaged senior management*. The policies and procedures were vetted and approved by senior management.

V. Conclusion

Cybersecurity remains one of the top compliance risks for financial firms.[9] As noted in OCIE's 2017 priorities, OCIE will continue to examine for cybersecurity compliance procedures and controls, including testing the implementation of those procedures and controls at firms.[10]

This Risk Alert is intended to highlight for firms the risks and issues that the staff identified during examinations of broker-dealers, investment advisers, and investment companies regarding cybersecurity preparedness. In addition, this Risk Alert describes factors that firms may consider to (1) assess their supervisory, compliance and/or other risk management systems related to cybersecurity risks, and (2) make any changes, as may be appropriate, to address or strengthen such systems. These factors are not exhaustive, nor will they constitute a safe harbor. Factors other than those described in this Risk Alert may be appropriate to consider, and some of the factors may not be applicable to a particular firm's business. While some of the factors discussed in this Risk Alert reflect existing regulatory requirements, they are not intended to alter such requirements. Moreover, future changes in laws or regulations may supersede some of the factors or issues raised herein. The adequacy of supervisory, compliance, and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.

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[9] *See, e.g.*, Investment Adviser Association, ACA Compliance Group, and OMAM, *2016 Investment Management Compliance Testing Survey* (June 23, 2016), which synthesizes 730 adviser compliance professionals' responses to 94 compliance-related questions. Q94: 88% of advisers view cybersecurity, privacy, and identity theft as the hottest compliance topic for 2016.

[10] OCIE, *Examination Priorities for 2017* (January 12, 2017).

RISK ALERT
OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS

April 16, 2019

Investment Adviser and Broker-Dealer Compliance Issues Related to Regulation S-P – Privacy Notices and Safeguard Policies

I. Introduction

Key Takeaway: Through sharing some of the Regulation S-P compliance issues it observed, OCIE encourages registrants to review their written policies and procedures, including implementation of those policies and procedures, to ensure compliance with the relevant regulatory requirements.

The Office of Compliance Inspections and Examinations ("OCIE")* is providing a list of compliance issues related to Regulation S-P, the primary SEC rule regarding privacy notices and safeguard policies of investment advisers and broker-dealers.[1] These issues were identified in recent examinations of SEC-registered investment advisers ("advisers") and brokers and dealers ("broker-dealers," and together with advisers, "registrants" or "firms").[2] The information in this Risk Alert is intended to assist advisers and broker-dealers in providing compliant privacy and opt-out notices, and in adopting and implementing effective policies and procedures for safeguarding customer records and information, under Regulation S-P.[3]

Privacy and Opt-Out Notices

Regulation S-P, among other things, requires a registrant to: (1) provide a clear and conspicuous notice to its customers that accurately reflects its privacy policies and practices generally no later than when it establishes a customer relationship ("Initial

* The views expressed herein are those of the staff of OCIE. The Securities and Exchange Commission ("SEC") has expressed no view on the contents of this Risk Alert. This document was prepared by OCIE staff and is not legal advice.

[1] *See* 17 CFR Part 248, Subpart A, and Appendix A to Subpart A. *See also* Privacy of Consumer Financial Information (Regulation S-P), Release Nos. 34-42974, IC-24543, IA-1883 (June 22, 2000) (adopting rules implementing the privacy provisions of Subtitle A of Title V of the Gramm- Leach-Bliley Act ("GLBA") with respect to financial institutions regulated by the SEC); Disposal of Consumer Report Information, Release Nos. 34-50781, IA-2332, IC-26685 (December 2, 2004) (adding rule requiring proper disposal of consumer report information (17 CFR 248.30(b), "Disposal Rule") and amending rule requiring policies and procedures reasonably designed to safeguard customer records and information (17 CFR 248.30(a), "Safeguards Rule") to require written policies and procedures); Final Model Privacy Form under the Gramm-Leach-Bliley Act, Release Nos. 34-61003, IA-2950, IC-28997 (November 16, 2009) (adding model privacy form and instructions in appendix).

[2] This Risk Alert reflects issues identified in deficiency letters from broker-dealer and adviser exams completed during the past two years. This Risk Alert does not discuss all types of deficiencies or weaknesses related to Regulation S-P that have been identified by staff.

[3] This Risk Alert does not discuss all requirements of Regulation S-P.

Privacy Notice"),[4] (2) provide a clear and conspicuous notice to its customers that accurately reflects its privacy policies and practices not less than annually during the continuation of the customer relationship ("Annual Privacy Notice,"[5] and together with the Initial Privacy Notice, "Privacy Notices"),[6] and (3) deliver a clear and conspicuous notice to its customers that accurately explains the right to opt out of some disclosures of non-public personal information about the customer to nonaffiliated third parties ("Opt-Out Notice").[7] Regulation S-P describes the information that must be included in Privacy Notices, including the categories of nonpublic personal information that the registrant collects and discloses, and in Opt-Out Notices.[8]

Written Safeguarding Policies and Procedures to Safeguard Customer Information

The Safeguards Rule of Regulation S-P requires registrants to adopt written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information.[9] These written policies and procedures must be reasonably designed to ensure the security and confidentiality of customer records and information, protect against any anticipated threats or hazards to the security or integrity of customer records and information, and protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer.

II. Most Frequent Regulation S-P Compliance Issues

Below are examples of the most common deficiencies or weaknesses identified by OCIE staff in connection with the Safeguards Rule.

A. *Privacy and Opt-Out Notices.* OCIE staff observed registrants that did not provide Initial Privacy Notices, Annual Privacy Notices and Opt-Out Notices to their customers. When such notices were provided to customers, the notices did not accurately reflect firms' policies and procedures. The staff also noted Privacy Notices that did not provide notice

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[4] 17 CFR 248.4. Regulation S-P defines "customer" to mean a consumer that has a customer relationship with a financial institution, and a "customer relationship" as a continuing relationship between a consumer and a financial institution and includes an individual who has a brokerage account with a broker-dealer or an advisory contract with an investment adviser (whether written or oral). 17 CFR 248.3(j)-(k). As used in this Risk Alert, "customer" refers to brokerage customers and advisory clients as applicable.

[5] 17 CFR 248.5. Section 75001 of the Fixing America's Surface Transportation Act, Pub. L. No. 114-94, 129 Stat. 1312 (2016), ("FAST Act") amended the GLBA by adding subsection 503(f) to provide an exception to the Annual Privacy Notice requirement. Under this exception, a financial institution is not required to provide an Annual Privacy Notice if the financial institution (1) does not share nonpublic personal information about the customer except for certain purposes that do not trigger the customer's statutory right to opt out and (2) has not changed its policies and practices with regard to disclosing nonpublic personal information from the policies and practices that were disclosed in the most recent Privacy Notice.

[6] The SEC has adopted a model form to satisfy Privacy Notice disclosure requirements. Use of the form provides a "safe harbor" for the required disclosures under Regulation S-P. 17 CFR 248.2. *See also* Final Model Privacy Form under the Gramm-Leach-Bliley Act, *supra* note 1.

[7] 17 CFR 248.7. Under the exceptions in 17 CFR 248.13, 248.14 and 248.15, however, an Opt-Out Notice is not required if the registrant shares nonpublic personal information with a non-affiliated third party for certain purposes.

[8] 17 CFR 248.6, 248.7.

[9] 17 CFR 248.30(a).

to customers of their right to opt out of the registrant sharing their nonpublic personal information with nonaffiliated third parties.

B. *Lack of policies and procedures.* OCIE staff observed registrants that did not have written policies and procedures as required under the Safeguards Rule. For example, firms had documents that restated the Safeguards Rule but did not include policies and procedures related to administrative, technical, and physical safeguards. The staff observed written policies and procedures that contained numerous blank spaces designed to be filled in by registrants. There were also firms with policies that addressed the delivery and content of a Privacy Notice, but did not contain any written policies and procedures required by the Safeguards Rule.

C. *Policies not implemented or not reasonably designed to safeguard customer records and information.* OCIE staff observed registrants with written policies and procedures that did not appear implemented or reasonably designed to (1) ensure the security and confidentiality of customer records and information, (2) protect against anticipated threats or hazards to the security or integrity of customer records and information, and (3) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to customers. For example, staff observed:

- Personal devices. Policies and procedures that did not appear reasonably designed to safeguard customer information on personal devices. For example, staff observed registrants' employees who regularly stored and maintained customer information on their personal laptops, but the registrants' policies and procedures did not address how these devices were to be properly configured to safeguard the customer information.

- Electronic communications. Policies and procedures that did not address the inclusion of customer personally identifiable information ("PII") in electronic communications. For example, staff observed registrants that did not appear to have policies and procedures reasonably designed to prevent employees from regularly sending unencrypted emails to customers containing PII.

- Training and monitoring. Policies and procedures that required customer information to be encrypted, password-protected, and transmitted using only registrant-approved methods were not reasonably designed because employees were not provided adequate training on these methods and the firm failed to monitor if the policies were being followed by employees.

- Unsecure networks. Policies and procedures that did not prohibit employees from sending customer PII to unsecure locations outside of the registrants' networks.

- Outside vendors. Registrants failed to follow their own policies and procedures regarding outside vendors. For example, staff observed registrants that failed to require outside vendors to contractually agree to keep customers' PII confidential, even though such agreements were mandated by the registrant's policies and procedures.

- PII inventory. Policies and procedures that did not identify all systems on which the registrant maintained customer PII. Without an inventory of all such systems, registrants may be unaware of the categories of customer PII that they maintain, which could limit their ability to adopt reasonably designed policies and procedures and adequately safeguard customer information.

- Incident response plans. Written incident response plans that did not address important areas, such as role assignments for implementing the plan, actions required to address a cybersecurity incident, and assessments of system vulnerabilities.[10]

- Unsecure physical locations. Customer PII that was stored in unsecure physical locations, such as in unlocked file cabinets in open offices.

- Login credentials. Customer login credentials that had been disseminated to more employees than permitted under firms' policies and procedures.

- Departed employees. Instances where former employees of firms retained access rights after their departure and therefore could access restricted customer information.

III. Conclusion

In response to these observations, many of the registrants modified their written policies and procedures to mitigate the issues identified by OCIE staff. OCIE encourages registrants to review their written policies and procedures, including implementation of those policies and procedures, to ensure that they are compliant with Regulation S-P.

This Risk Alert is intended to highlight for firms risks and issues that OCIE staff has identified. In addition, this Risk Alert describes risks that firms may consider to (i) assess their supervisory, compliance, and/or other risk management systems related to these risks, and (ii) make any changes, as may be appropriate, to address or strengthen such systems. Other risks besides those described in this Risk Alert may be appropriate to consider, and some issues discussed in this Risk Alert may not be relevant to a particular firm's business. The adequacy of supervisory, compliance and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.

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[10] For a discussion of related cybersecurity compliance issues, please see the OCIE Risk Alert Observations from Cybersecurity Examinations, August 7, 2017.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4204 / September 22, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16827

In the Matter of

R.T. Jones Capital Equities Management, Inc.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against R.T. Jones Capital Equities Management, Inc. ("R.T. Jones" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that

Summary

These proceedings arise out of R.T. Jones's failure to adopt written policies and procedures reasonably designed to protect customer records and information, in violation of Rule 30(a) of Regulation S-P (17 C.F.R. § 248.30(a)) (the "Safeguards Rule"). From at least September 2009 through July 2013, R.T. Jones stored sensitive personally identifiable information ("PII") of clients and other persons on its third party-hosted web server without adopting written policies and procedures regarding the security and confidentiality of that information and the protection of that information from anticipated threats or unauthorized access. In July 2013, the firm's web server was attacked by an unauthorized, unknown intruder, who gained access rights and copy rights to the data on the server. As a result of the attack, the PII of more than 100,000 individuals, including thousands of R.T. Jones's clients, was rendered vulnerable to theft.

Respondent

1. R.T. Jones, located in St. Louis, Missouri, is an investment adviser registered with the Commission that has approximately 8400 client accounts and about $480 million in regulatory assets under management. The firm does not have custody of client assets.

Background

2. Through agreements with a retirement plan administrator and various retirement plan sponsors, R.T. Jones provides investment advice to individual plan participants using a managed account option called Artesys. Artesys offers a variety of model portfolios that range in investment objectives and risk profiles. Plan participants can access the Artesys program through R.T. Jones's public website. Plan participants who elect to enroll in the program are instructed to fill out a questionnaire on the website regarding their investment objectives and risk tolerance. Based on information provided in the questionnaire, R.T. Jones recommends a particular portfolio allocation from among the Artesys models to the client. If the client agrees to the recommended allocation, R.T. Jones provides trade instructions to the retirement plan administrator, which then effects the transactions. R.T. Jones does not control or maintain client accounts or client account information.

3. During the relevant period, in order to verify eligibility to enroll in Artesys, R.T. Jones required prospective clients to log on to its website by entering their name, date of birth and social security number. The login information was then compared against the PII of eligible plan participants, which was provided to R.T. Jones by its plan sponsor partners. R.T. Jones stored this PII, without modification or encryption, on its third party-hosted web server. To facilitate the verification process, the plan sponsors provided R.T. Jones with information about all of their plan participants. Thus, even though R.T. Jones had fewer than 8000 plan participant clients, its web server contained the PII of over 100,000 individuals.

4. R.T. Jones limited access to the PII stored on the server to two individuals who held administrator status. In July 2013, R.T. Jones discovered a potential cybersecurity breach at its third party-hosted web server. R.T. Jones promptly retained more than one cybersecurity consulting firm to confirm the attack and assess the scope of the breach. One of the forensic cybersecurity firms reported that the cyberattack had been launched from multiple IP addresses, all of which traced back to mainland China, and that the intruder had gained full access rights and copy rights to the data stored on the server. However, the cybersecurity firms could not determine the full nature or extent of the breach because the intruder had destroyed the log files surrounding the period of the intruder's activity.

5. Soon thereafter, R.T. Jones retained another cybersecurity firm to review the initial report and independently assess the scope of the breach. Ultimately, the cybersecurity firms could not determine whether the PII stored on the server had been accessed or compromised during the breach.

6. Shortly after the breach incident, R.T. Jones provided notice of the breach to all of the individuals whose PII may have been compromised and offered them free identity monitoring through a third-party provider. To date, the firm has not learned of any information indicating that a client has suffered any financial harm as a result of the cyber attack.

R.T. Jones Failed to Adopt Written Policies and Procedures Reasonably Designed to Safeguard Customer Information

7. The Safeguards Rule, which the Commission adopted in 2000, requires that every investment adviser registered with the Commission adopt policies and procedures reasonably designed to: (1) insure the security and confidentiality of customer records and information; (2) protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer. The Commission adopted amendments to the Safeguards Rule, effective January 2005, to require that the policies and procedures adopted thereunder be in writing.

8. During the relevant period, R.T. Jones maintained client PII on its third party-hosted web server. However, the firm failed to adopt any written policies and procedures reasonably designed to safeguard its clients' PII as required by the Safeguards Rule. R.T. Jones's policies and procedures for protecting its clients' information did not include, for example: conducting periodic risk assessments, employing a firewall to protect the web server containing client PII, encrypting client PII stored on that server, or establishing procedures for responding to a cybersecurity incident. Taken as a whole, R.T. Jones's policies and procedures for protecting customer records and information were not reasonable to safeguard customer information.

Violations of the Federal Securities Laws

9. As a result of the conduct described above, R.T. Jones willfully[1] violated Rule 30(a) of Regulation S-P (17 C.F.R. § 248.30(a)), which requires registered investment advisers to adopt written policies and procedures that are reasonably designed to safeguard customer records and information.

Remedial Efforts

10. To mitigate against any future risk of cyber threats, R.T. Jones has appointed an information security manager to oversee data security and protection of PII, and adopted and implemented a written information security policy. Among other things, the firm no longer stores PII on its webserver and any PII stored on its internal network is encrypted. The firm has also installed a new firewall and logging system to prevent and detect malicious incursions. Finally, R.T. Jones has retained a cybersecurity firm to provide ongoing reports and advice on the firm's information technology security.

11. In determining to accept R.T. Jones's Offer, the Commission considered the remedial acts promptly undertaken by R.T. Jones and the cooperation R.T. Jones afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in R.T. Jones's Offer. Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent R.T. Jones cease and desist from committing or causing any violations and any future violations of Rule 30(a) of Regulation S-P (17 C.F.R. § 248.30(a));

B. Respondent R.T. Jones is censured; and

C. Respondent R.T. Jones shall pay, within 10 (ten) days of the entry of this Order, a civil money penalty in the amount of $75,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

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[1] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

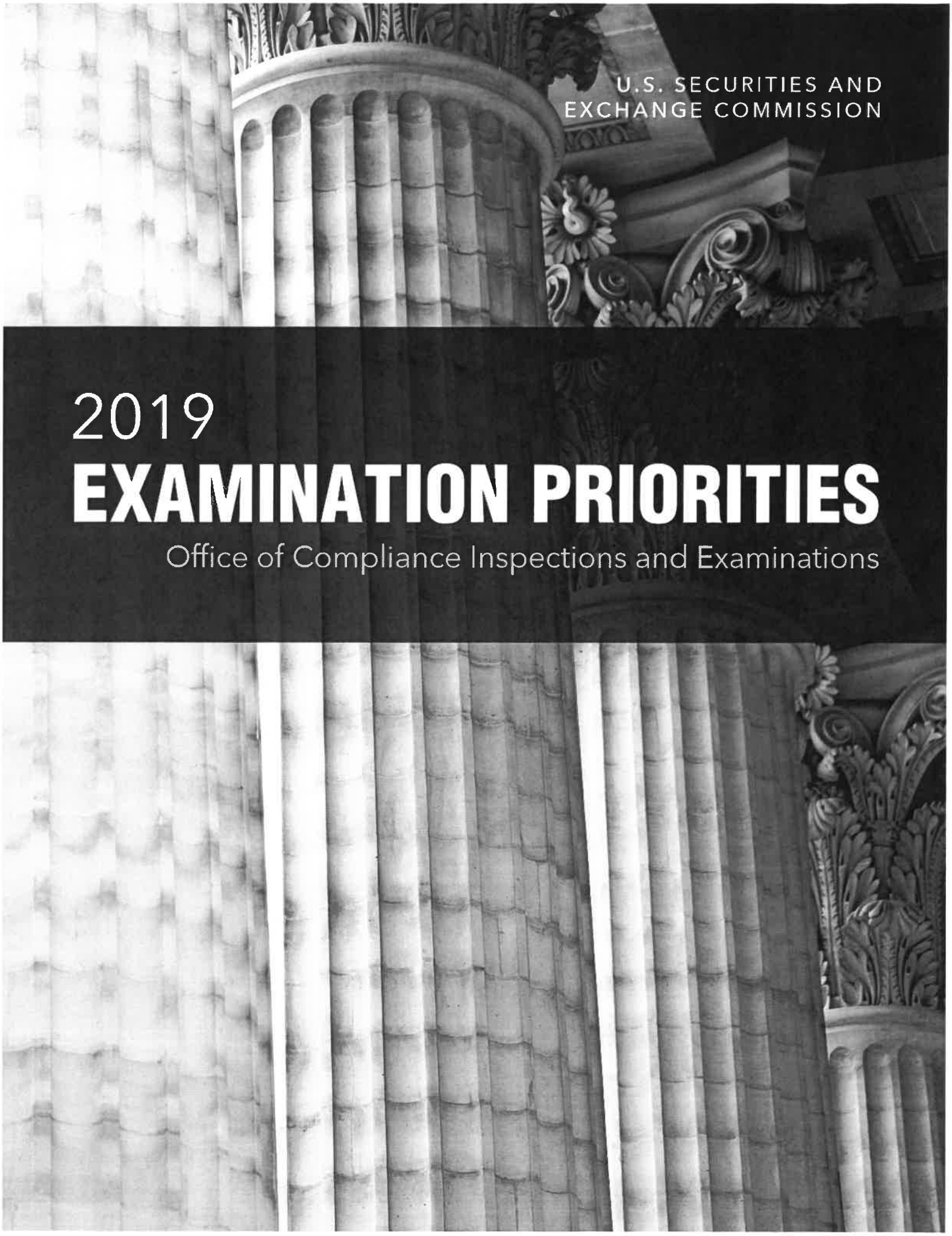
Payments by check or money order must be accompanied by a cover letter identifying R.T. Jones as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to: Paul Montoya, Assistant Regional Director, Asset Management Unit, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois, 60604.

By the Commission.

Brent J. Fields
Secretary

Supplemental Materials

Christopher S. Edwards



U.S. SECURITIES AND EXCHANGE COMMISSION

2019

EXAMINATION PRIORITIES

Office of Compliance Inspections and Examinations

CONTENTS

MESSAGE FROM OCIE'S LEADERSHIP TEAM

The Office of Compliance Inspections and Examinations (OCIE) of the U.S. Securities and Exchange Commission (SEC) is pleased to announce its 2019 examination priorities.

With approximately 1,000 staff in the Commission's 11 regional offices and headquarters, OCIE is responsible for overseeing more than 13,200 investment advisers, approximately 10,000 mutual funds and exchange traded funds, roughly 3,800 broker-dealers, about 330 transfer agents, 7 active clearing agencies, 21 national securities exchanges, nearly 600 municipal advisors, the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), the Securities Investor Protection Corporation, and the Public Company Accounting Oversight Board.

OCIE completed over 3,150 examinations in Fiscal Year (FY) 2018, which is a 10 percent increase over FY 2017. Coverage of investment advisers increased to approximately 17 percent of SEC-registered investment advisers, up from approximately 15 percent in 2017. Examinations of investment companies were also up this year, increasing by approximately 45 percent. OCIE completed over 300 examinations of broker-dealers and actively oversaw FINRA and other regulated entities.

DID YOU KNOW?

OCIE's work stands on four "pillars": promoting compliance, preventing fraud, identifying and monitoring risk, and informing policy.

The financial markets, products and services offered, and innovation in advanced technology continue to grow at a rapid pace. Operations of registered entities have also grown more complex, diverse, and interconnected, becoming more dependent on linkages to other organizations located throughout the world. In addition, the demands on OCIE's resources continue to grow with continued increases in the number of firms, particularly investment advisers registered with the SEC.

Over the past year, the number of registered investment advisers grew by nearly 5 percent, while the amount of assets managed by these advisers increased to approximately $84 trillion. The complexity of these advisers also continues to grow: more than 3,700 advisers have over one billion dollars in assets under management; approximately 35 percent manage a private fund; more than 50 percent have custody of client assets; more than 60 percent are affiliated with other financial industry firms; and approximately 12 percent provide advisory services to a mutual fund, exchange traded fund, or other registered investment company. For the broker-dealer community, despite the overall number of registered broker-dealers decreasing slightly, there were over 100 firms newly registered last year. Overall, broker-dealers operate more than 156,000 branch offices and approximately 10 percent of all broker-dealers are dually-registered with the SEC as investment advisers.

In 2019, OCIE will continue to stay abreast of changes in the SEC's registrant base, the markets, and investor needs and preferences, and will adjust its risk-based program in response to these changes. To this end, OCIE is increasingly leveraging technology and data analytics as well as human capital to fulfill its mission. This includes continually adding to and refining the expertise, tools, and applications that help identify areas of risk, firms that may present heightened risk of non-compliance, and activities that may harm investors.

The SEC's recently adopted Strategic Plan reiterated the importance of examinations. It described using examination resources to bolster regulatory requirements and protect investors as a "core principle" that the SEC has applied over the past 84 years to carry out its mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The SEC's Strategic Plan also is clear that future success requires the SEC to be efficient and nimble in the allocation of its resources. OCIE contributes to the fulfillment of the SEC's Strategic Plan by putting its limited resources to their highest and best use and performing high-quality, effective, efficient, and risk-targeted exams.

The priorities provide a preview of key areas where OCIE intends to focus its limited resources, but they do not encompass all of the areas that will be covered in examinations. To ensure the effective and efficient allocation of examination resources, OCIE proactively engages with registrants through outreach events, including national and regional compliance seminars. In FY 2018, OCIE staff participated in or held more than 100 such industry and regulatory outreach events.

OCIE also believes in the importance of engaging with senior leadership and boards of directors at registered entities. These efforts provide insight into evolving markets, including changes in risks to the markets and investors, market dynamics, and investor preferences. They also provide an opportunity to discuss with industry participants mission-related regulatory and market-impacting developments. The information obtained is also shared across the SEC through intra-agency working groups. These efforts have helped OCIE develop its risk-based approach and execute its examinations more effectively. The input received at these outreach and monitoring efforts were incorporated into the selection of the 2019 priorities.

OCIE measures performance in multiple ways and always against the backdrop of its four pillars: promoting compliance, preventing fraud, identifying and monitoring risk, and informing policy. Through the over 3,150 examinations, joint initiatives, outreach events and other efforts in 2018, OCIE's five program areas—Investment Adviser/Investment Company, Broker-Dealer and Exchanges, Clearance and Settlement (OCS), FINRA and Securities Industry Oversight, and the Technology Controls Program (TCP)—have advanced each pillar to the benefit of retail investors and the markets.

Promoting Compliance

- In response to the areas of concern and weaknesses identified in deficiency letters, firms often revised compliance policies and procedures, changed business practices, clarified a regulatory filing, or otherwise enhanced their disclosures.
- OCIE continued to prioritize transparency to investors, registrants, and the broader financial industry regarding its exam observations. Information about common compliance issues identified during examinations helps firms evaluate their own compliance policies and procedures and better identify weaknesses and areas for improvement. To foster transparency, OCIE has published the following five risk alerts since the publication of the 2018 priorities:
  - » Most Frequent Best Execution Issues Cited in Adviser Exams
  - » Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers
  - » Risk-Based Examination Initiatives Focused on Registered Investment Companies
  - » Investment Adviser Compliance Issues Related to the Cash Solicitation Rule
  - » Observations from Investment Adviser Examinations Relating to Electronic Messaging

- TCP issued a first-of-its-kind letter summarizing select examination findings from FYs 2016 and 2017 to entities subject to Regulation Systems Compliance and Integrity (Regulation SCI), a rule intended to help strengthen the technology infrastructure of the U.S. securities markets. The letter highlighted issues OCIE believes these entities would benefit from considering when assessing and improving cyber security, IT system resiliency, and technology-related policies and procedures.
- OCIE promoted compliance through thousands of investment adviser examinations as well as with staff discussions at the National Compliance Outreach Seminar for Investment Advisers and Investment Companies. At this outreach event, staff discussed a wide variety of topics, including program priorities, issues related to fees and expenses, portfolio management trends, cybersecurity, compliance, regulatory hot topics, and rulemaking.
- OCS promoted compliance during exams of Systemically Important Financial Market Utilities and other registered clearing agencies, identifying areas for improvement in governance, operational risk management, and public disclosure.

DID YOU KNOW?
In FY 2018, OCIE completed over 3,150 examinations—representing a 10 percent increase over FY 2017.

Preventing Fraud

- Examinations led to more than 160 enforcement referrals and resulted in firms returning more than $35 million to investors.
- OCIE conducted retail-targeted examinations of broker-dealers focused on preventing fraud, such as potential misappropriation and the sale of high risk securities by broker-dealers who may not conduct sufficient research into an investment and its appropriateness for a client.
- Examinations of investment advisers also aimed to prevent harm to retail investors, particularly seniors and those saving for retirement. For example, examinations identified advisers that selected or recommended more expensive mutual fund share classes for clients when lower cost share classes were available, and either failed to disclose or made inadequate disclosure about financial incentives they had to select or recommend the more expensive share classes. Examinations also identified compliance issues regarding advisory activities in branch offices, which resulted in enhancements to oversight practices.

Identifying and Monitoring Risk

- Examinations of firms required to comply with Regulation SCI, including the national securities exchanges, registered clearing agencies, FINRA, the MSRB, plan processors, and certain alternative trading systems (collectively, "SCI entities") identified many issues that, if left unresolved, could increase the risk of systems compromise or disruption at SCI entities and, in turn, increase risks to investors and the markets. Among other issues, certain SCI entities had insufficient policies and procedures related to: data loss prevention; vendor risk management; inventory management; and timely, consistent, and effective implementation of vendor-issued security patches. In addition, certain firms failed to report system disruptions or outages in a timely manner.
- Focused reviews of fixed income best execution obligations were conducted to identify and monitor risks, and examiners observed that many broker-dealers were not conducting sufficient reviews of execution quality to ensure that retail investors were receiving best execution.

- Investment adviser examinations identified emerging risks at advisers selling or recommending digital assets, such as concerns related to custody and safekeeping of investor assets, valuation, omitted or misleading disclosures regarding the complexities of the products and technology, and the risks of dramatic price volatility.

Informing Policy

- Examinations helped inform policy by providing further insight to other SEC Divisions and Offices regarding how registered entities have implemented the SEC's rules, the practical difficulties and challenges faced in complying with these rules, and common areas of non-compliance.
- Examinations into third party vendor management provided insight into, among other things, the use and management of cloud-based computing services.
- Examinations of compliance with the amended money market fund rules, disclosure relating to target fund glide path allocations, and fixed income cross trading practices provided valuable information about current practices in these areas.

The Coming Year

- In 2019, many of OCIE's priorities have changed as new risks have emerged and existing risks have heightened or been mitigated. While priorities shift, OCIE's commitment to the SEC's mission and doing the utmost to protect investors and serve the American people will never change.

INTRODUCTION

In 2019, OCIE will prioritize certain practices, products, and services that it believes present potentially heightened risk to investors or the integrity of the U.S. capital markets. Designed to support the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation, the six themes for OCIE's 2019 Examination Priorities, which include perennial risk areas and developing products and services, are:

1. Matters of importance to retail investors, including seniors and those saving for retirement;
2. Compliance and risk in registrants responsible for critical market infrastructure;
3. Select areas and programs of FINRA and MSRB;
4. Digital Assets;[1]
5. Cybersecurity; and
6. Anti-Money Laundering.

DID YOU KNOW?

In FY 2018, OCIE achieved examination coverage of approximately 17 percent of registered investment advisers, up from 9 percent just five years ago.

These priorities are not exhaustive and will not be the only issues OCIE addresses in its examinations, risk alerts, and investor and industry outreach. While the priorities drive many of OCIE's examinations, the scope of any examination is determined through a risk-based approach that includes analysis of the registrant's operations, products offered, and other factors. This risk-based approach often results in examinations that address key aspects of the SEC's regulatory oversight, such as the disclosure of services, fees, expenses, conflicts of interest for investment advisers, and trading and execution quality issues for broker-dealers.

OCIE's risk-based approach, both in selecting registered entities to examine and determining the scope of risk areas to examine, remains flexible in order to cover emerging and exigent risks to investors and the marketplace as they arise. OCIE is continually evaluating changes in market conditions, industry practices, and investor preferences to assess risks to both investors and the markets.

Although change may be continual, OCIE's analytic efforts and examinations remain firmly grounded in its four pillars: promoting compliance, preventing fraud, identifying and monitoring risk, and informing policy.

1 Digital Assets include cryptocurrencies, coins, and tokens.

RETAIL INVESTORS, INCLUDING SENIORS AND THOSE SAVING FOR RETIREMENT

OCIE prioritizes the protection of retail investors, particularly seniors and those saving for retirement, and pursues examinations of firms that provide products and services to these investors.

DID YOU KNOW?

In FY 2018, OCIE held a national investment adviser/investment company compliance outreach program, a compliance outreach program for municipal advisors, and participated in more than a hundred other outreach events in order to promote and improve industry compliance.

In furtherance of OCIE's commitment to retail investors, examinations will focus on the following areas:

Fees and Expenses: Disclosure of the Costs of Investing

Every dollar an investor pays in fees and expenses is a dollar not invested. It is critically important that investors are provided with proper disclosures of the fees and expenses they pay for products and services and that financial professionals accurately calculate and charge fees in accordance with these disclosures. OCIE will continue to review fees charged to advisory accounts, ensuring that the fees are assessed in accordance with the client agreements and firm disclosures.

For these examinations, OCIE will select firms with practices or business models that may create increased risks of inadequately disclosed fees, expenses, or other charges. With respect to mutual fund share classes, OCIE will continue to evaluate financial incentives for financial professionals that may influence their selection of particular share classes. In addition, OCIE remains focused on investment advisers participating in wrap fee programs, which charge investors a single bundled fee for both advisory and brokerage services. Continued areas of interest include the adequacy of disclosures and brokerage practices.

Conflicts of Interest

As fiduciaries, investment advisers have a duty to act and provide advice in the best interests of their clients. Ensuring that investment advisers are acting in a manner consistent with their fiduciary duty and meeting their contractual obligations to their clients is paramount to maintaining investor confidence in the markets and investment professionals.

Conflicts of interest provide incentives for financial professionals to recommend certain types of products and services. Examinations will review policies and procedures addressing the following:

Use of Affiliated Service Providers and Products: Advisers in some cases utilize services or products provided by affiliated entities. These arrangements present conflicts of interest related to, among other areas, portfolio management practices and compensation arrangements. OCIE will examine such arrangements, focusing on the impact to clients and the related disclosures of conflicts of interest that may be present.

Securities-Backed Non-Purpose Loans and Lines of Credit: A non-purpose loan or line of credit allows borrowers to use the securities in their brokerage or advisory accounts as collateral to obtain a loan, the proceeds of which cannot be used for purchasing or trading securities. OCIE has observed that advisers, broker-dealers, and their employees receive certain financial incentives to recommend these products to clients and/or customers. OCIE will assess this practice to determine whether registrants are, among other things, adequately disclosing the risks to clients and any conflicts of interest presented by recommending these loans.[2]

Borrowing Funds from Clients: Borrowing funds from clients presents a number of conflicts of interest for an investment adviser. Where examiners observe this practice, emphasis will be on whether adequate disclosures, including the potentially poor or failing financial condition of the investment adviser, are made to the client and the investment adviser has acted consistently with these disclosures.

Senior Investors and Retirement Accounts and Products

OCIE will conduct examinations that review how broker-dealers oversee their interactions with senior investors, including their ability to identify financial exploitation of seniors. In examinations of investment advisers, OCIE will continue to review the services and products offered to seniors and those saving for retirement. These examinations will focus on, among other things, compliance programs of investment advisers, the appropriateness of certain investment recommendations to seniors, and the supervision by firms of their employees and independent representatives.

Portfolio Management and Trading

Reviewing portfolio management processes is an integral component to investment adviser examinations. OCIE will review firms' practices for executing investment transactions on behalf of clients, fairly allocating investment opportunities among clients, ensuring consistency of investments with the objectives obtained from clients, disclosing critical information to clients, and complying with other legal restrictions.

OCIE will also examine investment adviser portfolio recommendations to assess, among other things, whether investment or trading strategies of advisers are: (1) suitable for and in the best interests of investors based on their investment objectives and risk tolerance; (2) contrary to, or have drifted from, disclosures to investors; (3) venturing into new, risky investments or products without adequate risk disclosure; and (4) appropriately monitored for attendant risks.

Never-Before or Not Recently-Examined Investment Advisers

OCIE will continue to conduct risk-based examinations of certain investment advisers that have never been examined, including newly-registered investment advisers as well as those registered for several years but that have yet to be examined. OCIE will also prioritize examinations of certain investment advisers that have not been examined for a number of years and may have substantially grown or changed business models.

2 See Investor Alert: Securities-Backed Lines of Credit, issued by the SEC's Office of Investor Education and Advocacy and FINRA, available at https://www.sec.gov/oiea/investor-alerts-bulletins/sbloc.html.

Mutual Funds and Exchange Traded Funds

Mutual funds and exchange traded funds (ETFs) are the primary investment vehicles for many retail investors. OCIE will continue to prioritize examinations of these funds, the activities of their advisers, and oversight practices of their boards of directors. Examinations will assess industry practices and regulatory compliance in various areas that may have significant impact on retail investors.

OCIE will focus on risks associated with the following: (1) index funds that track custom-built or bespoke indexes; (2) ETFs with little secondary market trading volume and smaller assets under management; (3) funds with higher allocations to certain securitized assets; (4) funds with aberrational underperformance relative to their peer groups; (5) funds managed by advisers that are relatively new to managing Registered Investment Companies (RICs); and (6) advisers that provide advice to both RICs and private funds with similar investment strategies.

Municipal Advisors

Municipal advisors (MAs) provide advice to, or on behalf of, a municipal entity with respect to the issuance of municipal securities or municipal financial products. OCIE will continue to conduct select examinations of MAs that have never been examined, concentrating on whether these MAs have satisfied their registration requirements and professional qualifications as well as continuing education requirements. OCIE will also prioritize whether MAs provided the appropriate disclosures regarding their conflicts of interests or otherwise violated their fiduciary duty to a municipal entity. Examinations will also review for compliance with recently-effective MSRB rules, including those relating to advertisements by MAs and the standards of conduct for MAs obtaining CUSIP numbers on behalf of issuers.

DID YOU KNOW?

Broker-dealers operate more than 156,000 branch offices, and approximately 10 percent of all broker-dealers are dually registered with the SEC as investment advisers.

Broker-Dealers Entrusted with Customer Assets

Broker-dealers that hold customer cash and securities must abide by certain rules, including the Customer Protection Rule (Exchange Act Rule 15c3-3), and have a significant responsibility to ensure that those assets are safeguarded and accurately reported. The Customer Protection Rule restricts the use of customer assets and prevents the broker-dealer from using customer assets as working capital. Examinations of select broker-dealers will focus on compliance with this rule, as well as procedures and controls to promote compliance.

Microcap Securities

OCIE will continue examinations of broker-dealers involved in selling stocks of companies with a market capitalization of under $250 million. OCIE will look at a variety of areas, including reviewing for manipulative schemes (i.e., pump and dump schemes), compliance with Regulation SHO, which governs short sales, and compliance with Exchange Act Rule 15c2-11, which governs the submission and publication of quotations by broker-dealers for certain over-the-counter equity securities.

COMPLIANCE AND RISK IN REGISTRANTS RESPONSIBLE FOR CRITICAL MARKET INFRASTRUCTURE

Clearing Agencies

Clearing agencies promote market stability and efficiency and help to reduce risk by performing critical post trade services, including acting as intermediaries between and guarantors for buyers and sellers of securities, facilitating the settlement of investor trades, and acting as a depository for securities and other financial instruments. For example, clearing agencies may reconcile transaction information received from the parties to a trade, calculate settlement obligations, or hold securities as certificates or in electronic form to facilitate automated settlement. As a result, clearing agencies help ensure that trades settle on time and at the agreed upon terms.

DID YOU KNOW?
Clearing agencies perform a variety of services that help ensure trades settle on time and at the agreed upon terms.

OCIE will continue to conduct annual examinations of clearing agencies that the Financial Stability Oversight Council has designated as systemically important and for which, under the Dodd- Frank Act, the Commission is the supervisory agency. OCIE will also conduct risk-based examinations of other registered clearing agencies. Examinations will focus on: (1) compliance with the SEC's Standards for Covered Clearing Agencies and other federal securities laws applicable to registered clearing agencies; (2) whether clearing agencies have taken timely corrective action in response to prior examinations; and (3) other areas identified in collaboration with the SEC's Division of Trading and Markets and with other regulators.

Entities Subject to Regulation Systems Compliance and Integrity

Regulation SCI was adopted by the Commission to strengthen the technology infrastructure of the U.S. securities markets. Among other things, it requires SCI entities to establish, maintain, and enforce policies and procedures designed to ensure that their systems' capacity, integrity, resiliency, availability, and security are adequate to maintain their operational capability and promote the maintenance of fair and orderly markets. If certain events occur, these entities are required to take corrective action as soon as reasonably practical and immediately notify the SEC of the occurrence.

OCIE will continue to examine SCI entities to evaluate whether they have effectively implemented written policies and procedures required by Regulation SCI. OCIE will also focus on, among other things, controls relating to software development life cycles and related governance procedures, effectiveness of internal audit programs, inventory management, and threat management capabilities.

Transfer Agents

Transfer agents serve as agents for securities issuers and play a critical role in the settlement of securities transactions. Among their key functions, transfer agents are responsible for maintaining issuers' securityholder records, recording changes of ownership, canceling and issuing certificates, distributing dividends and other payments to securityholders, and facilitating communications between issuers and securityholders. Efficient transfer agent operations are critical to secondary securities markets and for recordkeeping during primary market activities. Examinations will assess transfers, recordkeeping, and the safeguarding of funds and securities. Examinations will also focus on the requirement for transfer agents to annually file a report by an independent accountant concerning the transfer agency's system of internal accounting controls.

Examination candidates will include transfer agents that serve as paying agents for issuers, transfer agents developing blockchain technology, or transfer agents that provide services to issuers of microcap securities, private offerings, crowdfunded securities, or digital assets.

National Securities Exchanges

With over 20 national securities exchanges facilitating transactions in the marketplace, OCIE will examine internal audit and surveillance programs and funding for regulatory programs.

FOCUS ON FINRA AND MSRB

FINRA

FINRA is a registered national securities association that adopts and enforces rules governing the conduct of its members. These members are also registered with the SEC as broker-dealers. FINRA oversees approximately 3,800 brokerage firms, 156,000 branch offices, and 630,000 registered representatives through examinations, enforcement, and surveillance. In addition, FINRA, among other things, provides a forum for securities arbitration and mediation, conducts market regulation, including by contract for a majority of national securities exchanges, reviews broker-dealer advertisements, administers the testing and licensing of registered persons, and operates industry utilities such as Trade Reporting Facilities. Examinations of FINRA will continue to focus on FINRA's operations and regulatory programs and the quality of FINRA's examinations of broker-dealers and municipal advisors that are also registered as broker-dealers.

DID YOU KNOW?

FINRA oversees approximately 3,800 brokerage firms, 156,000 branch offices, and 630,000 registered representatives through examinations, enforcement, and surveillance.

MSRB

MSRB regulates the activities of broker-dealers that buy, sell, and underwrite municipal securities, and municipal advisors. MSRB establishes rules for municipal securities dealers and municipal advisors, supports market transparency by making municipal securities trade data and disclosure documents available, and conducts education and outreach regarding the municipal securities market. OCIE, in coordination with FINRA, conducts examinations of MSRB members to ensure compliance with MSRB rules. Given MSRB's broad responsibility to regulate municipal securities transactions, OCIE will continue to conduct inspections of MSRB to evaluate the effectiveness of MSRB's policies, procedures, and controls.

DIGITAL ASSETS

The digital asset market has grown rapidly and may present risks to retail investors. The number of digital asset market participants, including broker-dealers, trading platforms, and investment advisers, also continues to increase. Given the significant growth and risks presented in this market, OCIE will continue to monitor the offer and sale, trading, and management of digital assets, and where the products are securities, examine for regulatory compliance. In particular, through high level inquiries, OCIE will take steps to identify market participants offering, selling, trading, and managing these products or considering or actively seeking to offer these products and then assess the extent of their activities. For firms actively engaged in the digital asset market, OCIE will conduct examinations focused on, among other things, portfolio management of digital assets, trading, safety of client funds and assets, pricing of client portfolios, compliance, and internal controls.

CYBERSECURITY

Cybersecurity protection is critical to the operation of the financial markets. The impact of a successful cyber-attack may have consequences that extend beyond the firm compromised to other market participants and retail investors, who may not be well informed of these risks and consequences. OCIE is working with firms to identify and manage cybersecurity risks and to encourage market participants to actively and effectively engage in this effort.

OCIE will continue to prioritize cybersecurity in each of its five examination programs. Examinations will focus on, among other things, proper configuration of network storage devices, information security governance generally, and policies and procedures related to retail trading information security. Specific to investment advisers, OCIE will emphasize cybersecurity practices at investment advisers with multiple branch offices, including those that have recently merged with other investment advisers, and continue to focus on, among other areas, governance and risk assessment, access rights and controls, data loss prevention, vendor management, training, and incident response.

ANTI-MONEY LAUNDERING PROGRAMS

The Bank Secrecy Act requires broker-dealers to establish anti-money laundering (AML) programs. These programs must, among other things, include policies and procedures reasonably designed to identify customers, perform customer due diligence, monitor for suspicious activity, and where appropriate, file suspicious activity reports (SARs) with the Financial Crimes Enforcement Network. SARs are used to detect and combat terrorist financing, public corruption, market manipulation, and a variety of other fraudulent behavior.

In 2019, OCIE will continue to prioritize examining broker-dealers for compliance with their AML obligations, including whether they are meeting their SAR filing obligations, implementing all elements of their AML program, and robustly and timely conducting independent tests of their AML program. The goal of these examinations is to ensure that broker-dealers have policies and procedures in place that are reasonably designed to identify suspicious activity and illegal money laundering activities.

CONCLUSION

These priorities reflect OCIE's assessment of certain risks, issues, and policy matters arising from market and regulatory developments, information gathered from examinations, and other sources, including tips, complaints, and referrals, and coordination with other regulators. OCIE welcomes comments and suggestions regarding how it can better fulfill its mission to promote compliance, prevent fraud, identify and monitor risk, and inform SEC policy. OCIE's contact information is available at https://www.sec.gov/ocie/ocie_org.htm. If you suspect or observe activity that may violate the federal securities laws or otherwise operates to harm investors, please notify SEC staff at https://www.sec.gov/tcr.

U.S. Securities and
Exchange Commission
100 F Street NE
Washington, DC 20549
SEC.gov

Version 1.0

POST-MONEY VALUATION CAP WITH DISCOUNT

THIS INSTRUMENT AND ANY SECURITIES ISSUABLE PURSUANT HERETO HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "**SECURITIES ACT**"), OR UNDER THE SECURITIES LAWS OF CERTAIN STATES. THESE SECURITIES MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED, PLEDGED OR HYPOTHECATED EXCEPT AS PERMITTED IN THIS SAFE AND UNDER THE ACT AND APPLICABLE STATE SECURITIES LAWS PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT OR AN EXEMPTION THEREFROM.

[COMPANY NAME]

SAFE
(Simple Agreement for Future Equity)

THIS CERTIFIES THAT in exchange for the payment by [Investor Name] (the "**Investor**") of $[_____] (the "**Purchase Amount**") on or about [Date of Safe], [Company Name], a [State of Incorporation] corporation (the "**Company**"), issues to the Investor the right to certain shares of the Company's Capital Stock, subject to the terms described below.

This Safe is one of the forms available at http://ycombinator.com/documents and the Company and the Investor agree that neither one has modified the form, except to fill in blanks and bracketed terms.

The "**Post-Money Valuation Cap**" is $[_____].

The "**Discount Rate**" is [*100 minus the discount*]%.

See **Section 2** for certain additional defined terms.

1. *Events*

(a) **Equity Financing**. If there is an Equity Financing before the termination of this Safe, on the initial closing of such Equity Financing, this Safe will automatically convert into the number of shares of Safe Preferred Stock equal to the Purchase Amount divided by the Conversion Price.

In connection with the automatic conversion of this Safe into shares of Safe Preferred Stock, the Investor will execute and deliver to the Company all of the transaction documents related to the Equity Financing; *provided,* that such documents are the same documents to be entered into with the purchasers of Standard Preferred Stock, with appropriate variations for the Safe Preferred Stock if applicable, and *provided further,* that such documents have customary exceptions to any drag-along applicable to the Investor, including, without limitation, limited representations and warranties and limited liability and indemnification obligations on the part of the Investor.

(b) **Liquidity Event**. If there is a Liquidity Event before the termination of this Safe, this Safe will automatically be entitled to receive a portion of Proceeds, due and payable to the Investor immediately prior to, or concurrent with, the consummation of such Liquidity Event, equal to the greater of (i) the Purchase Amount (the "**Cash-Out Amount**") or (ii) the amount payable on the number of shares of Common Stock equal to the Purchase Amount divided by the Liquidity Price (the "**Conversion Amount**"). If any of the Company's securityholders are given a choice as to the form and amount of Proceeds to be received in a Liquidity Event, the Investor will be given the same choice, *provided* that the Investor may not choose to receive a form of consideration that the Investor would be ineligible to receive as a result of the Investor's failure to satisfy any requirement or limitation generally applicable to the Company's securityholders, or under any applicable laws.

Notwithstanding the foregoing, in connection with a Change of Control intended to qualify as a tax-free reorganization, the Company may reduce the cash portion of Proceeds payable to the Investor by the amount determined by its board of directors in good faith for such Change of Control to qualify as a tax-free reorganization for U.S. federal income tax purposes, provided that such reduction (A) does not reduce the total Proceeds payable to such Investor and (B) is applied in the same manner and on a pro rata basis to all securityholders who have equal priority to the Investor under Section 1(d).

(c) **Dissolution Event**. If there is a Dissolution Event before the termination of this Safe, the Investor will automatically be entitled to receive a portion of Proceeds equal to the Cash-Out Amount, due and payable to the Investor immediately prior to the consummation of the Dissolution Event.

(d) **Liquidation Priority**. In a Liquidity Event or Dissolution Event, this Safe is intended to operate like standard non-participating Preferred Stock. The Investor's right to receive its Cash-Out Amount is:

(i) Junior to payment of outstanding indebtedness and creditor claims, including contractual claims for payment and convertible promissory notes (to the extent such convertible promissory notes are not actually or notionally converted into Capital Stock);

(ii) On par with payments for other Safes and/or Preferred Stock, and if the applicable Proceeds are insufficient to permit full payments to the Investor and such other Safes and/or Preferred Stock, the applicable Proceeds will be distributed pro rata to the Investor and such other Safes and/or Preferred Stock in proportion to the full payments that would otherwise be due; and

(iii) Senior to payments for Common Stock.

The Investor's right to receive its Conversion Amount is (A) on par with payments for Common Stock and other Safes and/or Preferred Stock who are also receiving Conversion Amounts or Proceeds on a similar as-converted to Common Stock basis, and (B) junior to payments described in clauses (i) and (ii) above (in the latter case, to the extent such payments are Cash-Out Amounts or similar liquidation preferences).

(e) **Termination**. This Safe will automatically terminate (without relieving the Company of any obligations arising from a prior breach of or non-compliance with this Safe) immediately following the earliest to occur of: (i) the issuance of Capital Stock to the Investor pursuant to the automatic conversion of this Safe under Section 1(a); or (ii) the payment, or setting aside for payment, of amounts due the Investor pursuant to Section 1(b) or Section 1(c).

2. ***Definitions***

"**Capital Stock**" means the capital stock of the Company, including, without limitation, the "**Common Stock**" and the "**Preferred Stock**."

"**Change of Control**" means (i) a transaction or series of related transactions in which any "person" or "group" (within the meaning of Section 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended), becomes the "beneficial owner" (as defined in Rule 13d-3 under the Securities Exchange Act of 1934, as amended), directly or indirectly, of more than 50% of the outstanding voting securities of the Company having the right to vote for the election of members of the Company's board of directors, (ii) any reorganization, merger or consolidation of the Company, other than a transaction or series of related transactions in which the holders of the voting securities of the Company outstanding immediately prior to such transaction or series of related transactions retain, immediately after such transaction or series of related transactions, at least a majority of the total voting power represented by the outstanding voting securities of the Company or such other surviving or resulting entity or (iii) a sale, lease or other disposition of all or substantially all of the assets of the Company.

"**Company Capitalization**" is calculated as of immediately prior to the Equity Financing and (without double-counting):

- Includes all shares of Capital Stock issued and outstanding;
- Includes all Converting Securities;
- Includes all (i) issued and outstanding Options and (ii) Promised Options;
- Includes the Unissued Option Pool; and
- Excludes, notwithstanding the foregoing, any increases to the Unissued Option Pool (except to the extent necessary to cover Promised Options that exceed the Unissued Option Pool) in connection with the Equity Financing.

"**Conversion Price**" means the either: (1) the Safe Price or (2) the Discount Price, whichever calculation results in a greater number of shares of Safe Preferred Stock.

"**Converting Securities**" includes this Safe and other convertible securities issued by the Company, including but not limited to: (i) other Safes; (ii) convertible promissory notes and other convertible debt instruments; and (iii) convertible securities that have the right to convert into shares of Capital Stock.

"**Discount Price**" means the price per share of the Standard Preferred Stock sold in the Equity Financing multiplied by the Discount Rate.

"**Dissolution Event**" means (i) a voluntary termination of operations, (ii) a general assignment for the benefit of the Company's creditors or (iii) any other liquidation, dissolution or winding up of the Company (**excluding** a Liquidity Event), whether voluntary or involuntary.

"**Dividend Amount**" means, with respect to any date on which the Company pays a dividend on its outstanding Common Stock, the amount of such dividend that is paid per share of Common Stock multiplied by (x) the Purchase Amount divided by (y) the Liquidity Price (treating the dividend date as a Liquidity Event solely for purposes of calculating such Liquidity Price).

"**Equity Financing**" means a bona fide transaction or series of transactions with the principal purpose of raising capital, pursuant to which the Company issues and sells Preferred Stock at a fixed valuation, including but not limited to, a pre-money or post-money valuation.

"**Initial Public Offering**" means the closing of the Company's first firm commitment underwritten initial public offering of Common Stock pursuant to a registration statement filed under the Securities Act.

"**Liquidity Capitalization**" is calculated as of immediately prior to the Liquidity Event, and (without double-counting):

- Includes all shares of Capital Stock issued and outstanding;
- Includes all (i) issued and outstanding Options and (ii) to the extent receiving Proceeds, Promised Options;
- Includes all Converting Securities, **other than** any Safes and other convertible securities (including without limitation shares of Preferred Stock) where the holders of such securities are receiving Cash-Out Amounts or similar liquidation preference payments in lieu of Conversion Amounts or similar "as-converted" payments; and
- Excludes the Unissued Option Pool.

"**Liquidity Event**" means a Change of Control or an Initial Public Offering.

"**Liquidity Price**" means the price per share equal to the Post-Money Valuation Cap divided by the Liquidity Capitalization.

"**Options**" includes options, restricted stock awards or purchases, RSUs, SARs, warrants or similar securities, vested or unvested.

"**Proceeds**" means cash and other assets (including without limitation stock consideration) that are proceeds from the Liquidity Event or the Dissolution Event, as applicable, and legally available for distribution.

"**Promised Options**" means promised but ungranted Options that are the greater of those (i) promised pursuant to agreements or understandings made prior to the execution of, or in connection with, the term sheet for the Equity Financing (or the initial closing of the Equity Financing, if there is no term sheet), or (ii) treated as outstanding Options in the calculation of the Standard Preferred Stock's price per share.

"**Safe**" means an instrument containing a future right to shares of Capital Stock, similar in form and content to this instrument, purchased by investors for the purpose of funding the Company's business operations. References to "this Safe" mean this specific instrument.

"**Safe Preferred Stock**" means the shares of the series of Preferred Stock issued to the Investor in an Equity Financing, having the identical rights, privileges, preferences and restrictions as the shares of Standard Preferred Stock, other than with respect to: (i) the per share liquidation preference and the initial conversion price for purposes of price-based anti-dilution protection, which will equal the Conversion Price; and (ii) the basis for any dividend rights, which will be based on the Conversion Price.

"**Safe Price**" means the price per share equal to the Post-Money Valuation Cap divided by the Company Capitalization.

"**Standard Preferred Stock**" means the shares of the series of Preferred Stock issued to the investors investing new money in the Company in connection with the initial closing of the Equity Financing.

"**Unissued Option Pool**" means all shares of Capital Stock that are reserved, available for future grant and not subject to any outstanding Options or Promised Options (but in the case of a Liquidity Event, only to the extent Proceeds are payable on such Promised Options) under any equity incentive or similar Company plan.

3. ***Company Representations***

(a) The Company is a corporation duly organized, validly existing and in good standing under the laws of its state of incorporation, and has the power and authority to own, lease and operate its properties and carry on its business as now conducted.

(b) The execution, delivery and performance by the Company of this Safe is within the power of the Company and has been duly authorized by all necessary actions on the part of the Company (subject to section 3(d)). This Safe constitutes a legal, valid and binding obligation of the Company, enforceable against the Company in accordance with its terms, except as limited by bankruptcy, insolvency or other laws of general application relating to or affecting the enforcement of creditors' rights generally and general principles of equity. To its knowledge, the Company is not in violation of (i) its current certificate of incorporation or bylaws, (ii) any material statute, rule or regulation applicable to the Company or (iii) any material debt or contract to which the Company is a party or by which it is bound, where, in each case, such violation or default, individually, or together with all such violations or defaults, could reasonably be expected to have a material adverse effect on the Company.

(c) The performance and consummation of the transactions contemplated by this Safe do not and will not: (i) violate any material judgment, statute, rule or regulation applicable to the Company; (ii) result in the acceleration of any material debt or contract to which the Company is a party or by which it is bound; or (iii) result in the creation or imposition of any lien on any property, asset or revenue of the Company or the suspension, forfeiture, or nonrenewal of any material permit, license or authorization applicable to the Company, its business or operations.

(d) No consents or approvals are required in connection with the performance of this Safe, other than: (i) the Company's corporate approvals; (ii) any qualifications or filings under applicable securities laws; and (iii) necessary corporate approvals for the authorization of Capital Stock issuable pursuant to Section 1.

(e) To its knowledge, the Company owns or possesses (or can obtain on commercially reasonable terms) sufficient legal rights to all patents, trademarks, service marks, trade names, copyrights, trade secrets, licenses, information, processes and other intellectual property rights necessary for its business as now conducted and as currently proposed to be conducted, without any conflict with, or infringement of the rights of, others.

4. ***Investor Representations***

(a) The Investor has full legal capacity, power and authority to execute and deliver this Safe and to perform its obligations hereunder. This Safe constitutes valid and binding obligation of the Investor, enforceable in accordance

with its terms, except as limited by bankruptcy, insolvency or other laws of general application relating to or affecting the enforcement of creditors' rights generally and general principles of equity.

(b) The Investor is an accredited investor as such term is defined in Rule 501 of Regulation D under the Securities Act, and acknowledges and agrees that if not an accredited investor at the time of an Equity Financing, the Company may void this Safe and return the Purchase Amount. The Investor has been advised that this Safe and the underlying securities have not been registered under the Securities Act, or any state securities laws and, therefore, cannot be resold unless they are registered under the Securities Act and applicable state securities laws or unless an exemption from such registration requirements is available. The Investor is purchasing this Safe and the securities to be acquired by the Investor hereunder for its own account for investment, not as a nominee or agent, and not with a view to, or for resale in connection with, the distribution thereof, and the Investor has no present intention of selling, granting any participation in, or otherwise distributing the same. The Investor has such knowledge and experience in financial and business matters that the Investor is capable of evaluating the merits and risks of such investment, is able to incur a complete loss of such investment without impairing the Investor's financial condition and is able to bear the economic risk of such investment for an indefinite period of time.

5. ***Miscellaneous***

(a) Any provision of this Safe may be amended, waived or modified by written consent of the Company and either (i) the Investor or (ii) the majority-in-interest of all then-outstanding Safes with the same "Post-Money Valuation Cap" and "Discount Rate" as this Safe (and Safes lacking one or both of such terms will be considered to be the same with respect to such term(s)), *provided that* with respect to clause (ii): (A) the Purchase Amount may not be amended, waived or modified in this manner, (B) the consent of the Investor and each holder of such Safes must be solicited (even if not obtained), and (C) such amendment, waiver or modification treats all such holders in the same manner. "Majority-in-interest" refers to the holders of the applicable group of Safes whose Safes have a total Purchase Amount greater than 50% of the total Purchase Amount of all of such applicable group of Safes.

(b) Any notice required or permitted by this Safe will be deemed sufficient when delivered personally or by overnight courier or sent by email to the relevant address listed on the signature page, or 48 hours after being deposited in the U.S. mail as certified or registered mail with postage prepaid, addressed to the party to be notified at such party's address listed on the signature page, as subsequently modified by written notice.

(c) The Investor is not entitled, as a holder of this Safe, to vote or be deemed a holder of Capital Stock for any purpose other than tax purposes, nor will anything in this Safe be construed to confer on the Investor, as such, any rights of a Company stockholder or rights to vote for the election of directors or on any matter submitted to Company stockholders, or to give or withhold consent to any corporate action or to receive notice of meetings, until shares have been issued on the terms described in Section 1. However, if the Company pays a dividend on outstanding shares of Common Stock (that is not payable in shares of Common Stock) while this Safe is outstanding, the Company will pay the Dividend Amount to the Investor at the same time.

(d) Neither this Safe nor the rights in this Safe are transferable or assignable, by operation of law or otherwise, by either party without the prior written consent of the other; *provided, however*, that this Safe and/or its rights may be assigned without the Company's consent by the Investor to any other entity who directly or indirectly, controls, is controlled by or is under common control with the Investor, including, without limitation, any general partner, managing member, officer or director of the Investor, or any venture capital fund now or hereafter existing which is controlled by one or more general partners or managing members of, or shares the same management company with, the Investor; and *provided, further*, that the Company may assign this Safe in whole, without the consent of the Investor, in connection with a reincorporation to change the Company's domicile.

(e) In the event any one or more of the provisions of this Safe is for any reason held to be invalid, illegal or unenforceable, in whole or in part or in any respect, or in the event that any one or more of the provisions of this Safe operate or would prospectively operate to invalidate this Safe, then and in any such event, such provision(s) only will be deemed null and void and will not affect any other provision of this Safe and the remaining provisions of this Safe will remain operative and in full force and effect and will not be affected, prejudiced, or disturbed thereby.

(f) All rights and obligations hereunder will be governed by the laws of the State of [Governing Law Jurisdiction], without regard to the conflicts of law provisions of such jurisdiction.

(g) The parties acknowledge and agree that for United States federal and state income tax purposes this Safe is, and at all times has been, intended to be characterized as stock, and more particularly as common stock for purposes of Sections 304, 305, 306, 354, 368, 1036 and 1202 of the Internal Revenue Code of 1986, as amended. Accordingly, the parties agree to treat this Safe consistent with the foregoing intent for all United States federal and state income tax purposes (including, without limitation, on their respective tax returns or other informational statements).

(*Signature page follows*)

IN WITNESS WHEREOF, the undersigned have caused this Safe to be duly executed and delivered.

[COMPANY]

By:_____
[*name*]
[*title*]

Address:_____

_____

Email:_____

INVESTOR:

By: _____

Name:_____

Title:_____

Address:_____

_____

Email:_____

THIS INSTRUMENT AND THE SECURITIES ISSUABLE UPON THE CONVERSION HEREOF HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED. THEY MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED, HYPOTHECATED, OR OTHERWISE TRANSFERRED EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT REGISTRATION IS NOT REQUIRED UNDER SUCH ACT OR UNLESS SOLD PURSUANT TO RULE 144 UNDER SUCH ACT.

SERIES [1]
KISS

"***Purchase Price***" "***Date of Issuance***"

$ _____, 201_

FOR VALUE RECEIVED, _____, Inc., a Delaware corporation (the "***Company***"), hereby promises to pay to the order of _____ (the "***Investor***"), the principal sum of the Purchase Price, together with interest thereon from the Date of Issuance. Interest shall accrue at the Interest Rate. Unless earlier converted into Conversion Shares pursuant to Section 2, the principal and accrued interest shall be due and payable by the Company on demand by the Majority in Interest at any time after the Maturity Date. This KISS is one of a series of Series [1] KISSes issued by the Company to investors with identical terms and on the same form as set forth herein (except that the Investor, Purchase Price and Date of Issuance may differ in each KISS) (collectively, the "***Series***").

1. Definitions.

(a) "***Conversion Shares***" shall mean:

(i) with respect to a conversion pursuant to Section 2.1, shares of the Company's Preferred Stock issued in the Next Equity Financing; provided, however, that, at the Company's election, "Conversion Shares" with respect to a conversion pursuant to Section 2.1 shall mean shares of a Shadow Series;

(ii) with respect to a conversion pursuant to Section 2.2, shares of the Company's Common Stock; and

(iii) with respect to a conversion pursuant to Section 2.3, shares of a newly created series of the Company's Series Seed Preferred Stock, upon the terms and provisions set forth in the most recent version of the Series Seed documents posted at www.seriesseed.com (or if not so posted, as reasonably agreed by the Company and a Majority in Interest); provided that, for the avoidance of doubt, the Conversion Price shall be determined pursuant to Section 1(b)(iii).

(b) "***Conversion Price***" shall equal:

(i) with respect to a conversion pursuant to Section 2.1, the lower of (A) the product of (1) one (1) *minus* the Discount and (2) the price paid per share for Preferred Stock by the investors in the Next Equity Financing or (B) the quotient resulting from dividing (1) the Valuation Cap by (2) the Fully-Diluted Capitalization immediately prior to the closing of the Next Equity Financing;

(ii) with respect to a conversion pursuant to Section 2.2, the quotient resulting from dividing (A) the Valuation Cap by (B) the Fully-Diluted Capitalization immediately prior to the closing of the Corporate Transaction; and

(iii) with respect to a conversion pursuant to Section 2.3, the quotient resulting from dividing (A) the Valuation Cap by (B) the Fully-Diluted Capitalization immediately prior to the conversion.

(c) "***Corporate Transaction***" shall mean (i) the closing of the sale, transfer or other disposition of all or substantially all of the Company's assets, (ii) the consummation of the merger or consolidation of the Company with or into another entity (except a merger or consolidation in which the holders of capital stock of the Company immediately prior to such merger or consolidation continue to hold at least 50% of the voting power of the capital stock of the Company or the surviving or acquiring entity), (iii) the closing of the transfer (whether by merger, consolidation or otherwise), in one transaction or a series of related transactions, to a person or group of affiliated persons (other than an underwriter of the Company's securities), of the Company's securities if, after such closing, such person or group of affiliated persons would hold 50% or more of the outstanding voting stock of the Company (or the surviving or acquiring entity), or (iv) the liquidation, dissolution or winding up of the Company; provided, however, that a transaction shall not constitute a Corporate Transaction if its sole purpose is to change the state of the Company's incorporation or to create a holding company that will be owned in substantially the same proportions by the persons who held the Company's securities immediately prior to such transaction. Notwithstanding the prior sentence, the sale of shares of Preferred Stock in a bona fide financing transaction shall not be deemed a "Corporate Transaction."

(d) "***Corporate Transaction Payment***" shall mean an amount equal to all accrued and unpaid interest due on this KISS *plus* two times (2X) the Purchase Price.

(e) "***Discount***" shall mean _____ percent (__%).

(f) "***Equity Securities***" shall mean the Company's Common Stock or Preferred Stock or any securities conferring the right to purchase the Company's Common Stock or Preferred Stock or securities convertible into, or exchangeable for (with or without additional consideration), the Company's Common Stock or Preferred Stock, except any security granted, issued and/or sold by the Company to any director, officer, employee or consultant of the Company in such capacity for the primary purpose of soliciting or retaining their services.

(g) "***Financial Statements***" shall mean an income statement, balance sheet, statement of stockholders' equity, and/or a statement of cash flows, in each case as of the end of (i) each of the first three (3) fiscal quarters and (ii) each fiscal year of the Company.

(h) "***Fully-Diluted Capitalization***" shall mean the number of shares of outstanding Common Stock of the Company on a fully-diluted basis, including (i) conversion or exercise of all securities convertible into or exercisable for Common Stock, (ii) exercise of all outstanding options and warrants to purchase Common Stock and, in the case of Section 1(b)(i) and 1(b)(iii) only, (iii) the shares reserved or authorized for issuance under the Company's existing stock option plan or any stock option plan created or increased in connection with such transaction; but excluding, for this purpose, the conversion contemplated by the applicable provision of Section 2.

(i) "***Holder***" shall mean a member of the KISS Group that holds a KISS (including, without limitation, the Investor, for so long as the Investor holds this KISS).

(j) "***Interest Rate***" shall mean a rate of four percent (4%) per annum, compounded annually.

(k) "***KISS***" or "***KISSes***" shall mean the KISS instruments issued by the Company to Holders in the form hereof.

(l) "***KISS Group***" shall mean the holders of all KISSes in the Series, collectively.

(m) "***Majority in Interest***" shall mean members of the KISS Group holding a majority in interest of the aggregate Purchase Prices of all KISSes in the Series.

(n) "***Maturity Date***" shall mean the date that is eighteen (18) months following the Date of Issuance.

(o) "***Next Equity Financing***" shall mean the next sale (or series of related sales) by the Company of its Preferred Stock following the Date of Issuance from which the Company receives gross proceeds of not less than $1,000,000 (excluding the aggregate amount of securities converted into Preferred Stock in connection with such sale (or series of related sales)).

(p) "***Participation Amount***" shall mean an amount in US dollars equal to one times (1X) the Purchase Price.

(q) "***Shadow Series***" shall mean shares of a series of the Company's Preferred Stock that is identical in all respects to the shares of Preferred Stock issued in the Next Equity Financing (e.g., if the Company sells Series A Preferred Stock in the Next Equity Financing, the Shadow Series would be Series A-1 Preferred Stock), except that the liquidation preference per share of the Shadow Series shall equal the Conversion Price (as determined pursuant to Section 1(b)(i)), with corresponding adjustments to any price-based antidilution and dividend rights provisions.

(r) "***Valuation Cap***" shall mean US$__,000,000.

2. Conversion of the KISS.

2.1 Next Equity Financing. Upon the closing of the Next Equity Financing, this KISS will be automatically converted into that number of Conversion Shares equal to the quotient obtained by dividing the Purchase Price and unpaid accrued interest on this KISS by the Conversion Price. Notwithstanding the foregoing, accrued interest on this KISS may be paid in cash at the option of the Company. At least five (5) days prior to the closing of the Next Equity Financing, the Company shall notify the Investor in writing of the terms under which the Preferred Stock of the Company will be sold in such financing. The issuance of Conversion Shares pursuant to the conversion of this KISS shall be upon and subject to the same terms and conditions applicable to the Preferred Stock sold in the Next Equity Financing (or the Shadow Series, as applicable).

2.2 Corporate Transaction. In the event of a Corporate Transaction prior to the conversion of this KISS pursuant to Section 2.1 or 2.3, at Investor's election, (i) this KISS shall be converted into that number of Conversion Shares equal to the quotient obtained by dividing the Purchase Price and unpaid accrued interest on this KISS by the Conversion Price; or (ii) the Investor shall be paid the Corporate Transaction Payment. At least ten (10) days prior to the closing of the Corporate Transaction, the Company shall notify the Investor in writing of the terms of the Corporate Transaction.

2.3 Maturity Conversion. Unless earlier converted to Conversion Shares or paid pursuant to Section 2.1 or 2.2, at the election of the Majority in Interest at any time on or after the Maturity Date, this KISS shall be converted into that number of Conversion Shares equal to the quotient obtained by dividing the Purchase Price and unpaid accrued interest on this KISS by the Conversion Price.

2.4 No Fractional Shares. Upon the conversion of this KISS into Conversion Shares, in lieu of any fractional shares to which the holder of this KISS would otherwise be entitled, the Company shall pay the holder cash equal to such fraction multiplied by the Conversion Price.

2.5 Mechanics of Conversion. As promptly as practicable after the conversion of this KISS, the Company at its expense will issue and deliver to the Investor, upon surrender of this KISS, a certificate or certificates for the number of Conversion Shares. Conversion of this KISS may be made contingent upon the closing of the Next Equity Financing or Corporate Transaction.

3. Representations and Warranties of the Company. In connection with the transactions provided for herein, the Company hereby represents and warrants to the Investor that:

3.1 Organization, Good Standing and Qualification. The Company is a corporation duly organized, validly existing, and in good standing under the laws of the State of Delaware and has all requisite corporate power and authority to carry on its business as now conducted. The Company is duly qualified to transact business and is in good standing in each

jurisdiction in which the failure to so qualify would have a material adverse effect on its business or properties.

3.2 Authorization. Except for the authorization and issuance of the Conversion Shares issuable in connection with the Next Equity Financing, a Corporate Transaction or an optional conversion on or after the Maturity Date, all corporate action has been taken on the part of the Company, its officers, directors and stockholders necessary for the authorization, execution and delivery of this KISS. The Company has taken all corporate action required to make all of the obligations of the Company reflected in the provisions of this KISS the valid and enforceable obligations they purport to be, and this KISS, when executed and delivered by the Company, shall constitute the valid and legally binding obligation of the Company, enforceable against the Company in accordance with its terms.

3.3 Offering. Subject in part to the truth and accuracy of the Investor's representations set forth herein, the offer, sale and issuance of this KISS are exempt from the registration requirements of any applicable state and federal securities laws, and neither the Company nor any authorized agent acting on its behalf will take any action hereafter that would cause the loss of such exemption.

3.4 Compliance with Other Instruments. The execution, delivery and performance of this KISS, and the consummation of the transactions contemplated hereby, will not constitute or result in a default, violation, conflict or breach in any material respect of any provision of the Company's current Certificate of Incorporation or bylaws, or in any material respect of any instrument, judgment, order, writ, decree, privacy policy or contract to which it is a party or by which it is bound, or, to its knowledge, of any provision of any federal or state statute, rule or regulation applicable to the Company.

3.5 Valid Issuance of Stock. The Conversion Shares, when issued, sold and delivered upon conversion of this KISS, will be duly authorized and validly issued, fully paid and nonassessable, will be free of restrictions on transfer other than restrictions on transfer set forth herein and pursuant to applicable state and federal securities laws and, based in part upon the representations and warranties of the Investor herein, will be issued in compliance with all applicable federal and state securities laws.

3.6 Intellectual Property. To its knowledge, the Company owns or possesses or believes it can acquire on commercially reasonable terms sufficient legal rights to all patents, patent applications, trademarks, trademark applications, service marks, tradenames, copyrights, trade secrets, licenses, domain names, mask works, information and proprietary rights and processes as are necessary to the conduct of its business as now conducted and as presently proposed to be conducted without any known conflict with, or infringement of, the rights of others. The Company has not received any communications alleging that the Company has violated or, by conducting its business, would violate any of the patents, trademarks, service marks, tradenames, copyrights, trade secrets, mask works or other proprietary rights or processes of any other person.

3.7 Litigation. To the Company's knowledge, there is no private or governmental action, suit, proceeding, claim, arbitration or investigation pending before any

agency, court or tribunal, foreign or domestic, or threatened against the Company or any of its properties or any of its officers or managers (in their capacities as such). There is no judgment, decree or order against the Company, or, to the knowledge of the Company, any of its directors or managers (in their capacities as such), that could prevent, enjoin, or materially alter or delay any of the transactions contemplated by this KISS, or that could reasonably be expected to have a material adverse effect on the Company.

4. Representations and Warranties of the Investor. In connection with the transactions provided for herein, the Investor hereby represents and warrants to the Company that:

4.1 Authorization. This KISS constitutes Investor's valid and legally binding obligation, enforceable in accordance with its terms, except as may be limited by (i) applicable bankruptcy, insolvency, reorganization, or similar laws relating to or affecting the enforcement of creditors' rights and (ii) laws relating to the availability of specific performance, injunctive relief or other equitable remedies.

4.2 Purchase Entirely for Own Account. Investor acknowledges that this KISS is issued to Investor in reliance upon Investor's representation to the Company that the KISS will be acquired for investment for Investor's own account, not as a nominee or agent, and not with a view to the resale or distribution of any part thereof, and that such Investor has no present intention of selling, granting any participation in, or otherwise distributing the same.

4.3 Investment Experience. Investor is an investor in securities of companies in the development stage and acknowledges that it is able to fend for itself, can bear the economic risk of its investment, and has such knowledge and experience in financial or business matters that it is capable of evaluating the merits and risks of the investment in this KISS. Investor also represents it has not been organized solely for the purpose of acquiring this KISS.

4.4 Accredited Investor. Investor is an "accredited investor" within the meaning of Rule 501 of Regulation D, as presently in effect, as promulgated by the Securities and Exchange Commission (the "***SEC***") under the Securities Act of 1933, as amended (the "***Act***").

4.5 Restricted Security. Investor understands that this KISS is characterized as a "restricted security" under the federal securities laws inasmuch as it is being acquired from the Company in a transaction not involving a public offering and that under such laws and applicable regulations such securities may be resold without registration under the Act, only in certain limited circumstances.

5. Miscellaneous.

5.1 Most Favored Nation. In the event the Company sells or issues any convertible instruments (other than the issuance of stock options to service providers of the Company) at any time prior to the earlier of (a) conversion of this KISS, (b) a Corporate Transaction or (c) payment in full of all outstanding principal and accrued interest in accordance with this KISS, the Company shall provide the Investor with written notice of such sale or issuance no later than five (5) days after the closing date thereof, including the price and terms of

such convertible instruments (the "***Subsequent Instruments***"). In the event the Investor determines, in its sole and absolute discretion, that any Subsequent Instrument contains terms more favorable to the holder(s) thereof than the terms set forth in this KISS, the Investor may elect to exchange this KISS for a Subsequent Instrument.

5.2 Major Investor Rights. In the event the Investor, together with its affiliates, purchases one or more KISSes with an aggregate Purchase Price equal to or exceeding $50,000 (a "***Major Investor***"), the Company shall provide such Major Investor with the following rights:

(a) Information Rights. To the extent that the Company prepares Financial Statements, the Company shall deliver to the Major Investor such Financial Statements upon request, as soon as practicable, but in any event within thirty (30) days after the end of each of the first three (3) quarters of each fiscal year of the Company and within ninety (90) days after the end of each fiscal year of the Company. Such Financial Statements shall be in reasonable detail and prepared on a consistent basis. Additionally, regardless of whether the Company prepares Financial Statements, the Company shall deliver to the Major Investor such information relating to the financial condition, business or corporate affairs of the Company as such Major Investor may from time to time reasonably request. Notwithstanding anything to the contrary in this Section 5.2(a), the Company shall not be obligated under this Section 5.2(a) to provide information that (x) it deems in good faith to be a trade secret or highly confidential information or (y) the disclosure of which would adversely affect the attorney-client privilege between the Company and its counsel; and the Investor agrees to maintain the confidentiality of all of the information provided to the Investor under this Section 5.2(a) and agrees not to use such information other than for a purpose reasonably related to the Investor's investment in the Company.

(b) Participation Rights. Each time the Company proposes to offer any Equity Securities at any time through and including the closing of the Next Equity Financing, the Company shall provide the Major Investor with at least ten (10) business days prior written notice of such offering, including the price and terms thereof. The Major Investor shall have a right of first offer to participate in such offering(s), on the same terms and for the same price as all other investors in such offering(s), by purchasing an aggregate number of Equity Securities (whether in one offering or across multiple offerings) valued at up to the Participation Amount. The Major Investor's right of first offer set forth in this Section 5.2(b) shall be subject to compliance with applicable federal and state securities laws.

(c) "Major Investor" Rights. The Company shall ensure that the Major Investor shall be deemed to be a "Major Investor" (or such similar term) for all purposes, including, without limitation, rights of first offer and information rights, in relevant financing documents related to all subsequent sales of Equity Securities, to the extent such concept exists.

5.3 Payment. All payments, if any, shall be made in lawful money of the United States of America. Payment shall be credited first to Costs (as defined below), if any, then to accrued interest due and payable and any remainder applied to principal or the Corporate Transaction Payment, as applicable. Prepayment of principal, together with accrued interest,

may not be made without the prior written consent of the Investor. The Company hereby waives demand, notice, presentment, protest and notice of dishonor.

5.4 Costs, Expenses and Attorneys' Fees; Indemnity. The Company hereby agrees, subject only to any limitation imposed by applicable law, to pay all expenses, including reasonable attorneys' fees and legal expenses, incurred by the holder of this KISS in endeavoring to collect any amounts payable hereunder which are not paid when due, whether by declaration or otherwise ("***Costs***"). The Company agrees that any delay on the part of the holder in exercising any rights hereunder will not operate as a waiver of such rights. The holder of this KISS shall not by any act, delay, omission or otherwise be deemed to have waived any of its rights or remedies, and no waiver of any kind shall be valid unless in writing and signed by the party or parties waiving such rights or remedies. If any action at law or in equity is necessary to enforce or interpret the terms of this KISS, the prevailing party shall be entitled to reasonable attorneys' fees, costs and necessary disbursements in addition to any other relief to which such party may be entitled. The Company shall indemnify and hold the Investor harmless from any loss, cost, liability and legal or other expense, including attorneys' fees of the Investor's counsel, which the Investor may directly or indirectly suffer or incur by reason of the failure of the Company to perform any of its obligations under this KISS or any agreement executed in connection herewith; provided, however, that the indemnity agreement contained in this Section 5.4 shall not apply to liabilities which the Investor may directly or indirectly suffer or incur by reason of the Investor's own gross negligence or willful misconduct.

5.5 Security. This KISS is a general unsecured obligation of the Company.

5.6 Successors and Assigns. The terms and conditions of this KISS shall inure to the benefit of and be binding upon the respective successors and assigns of the parties hereto; provided, however, that the Company may not assign its obligations under this KISS without the prior written consent of the Investor.

5.7 Governing Law. This KISS shall be governed by and construed under the laws of the State of California as applied to other instruments made by California residents to be performed entirely within the State of California, regardless of the laws that might otherwise govern under applicable principles of conflicts of law.

5.8 Notices. All notices and other communications given or made pursuant to this KISS shall be in writing and shall be deemed effectively given upon the earlier of actual receipt or: (a) personal delivery to the party to be notified, (b) when sent, if sent by electronic mail or facsimile during normal business hours of the recipient, and if not sent during normal business hours, then on the recipient's next business day, (c) five (5) days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (d) one (1) business day after deposit with a nationally recognized overnight courier, freight prepaid, specifying next business day delivery, with written verification of receipt.

5.9 Financing Agreements. The Investor understands and agrees that the conversion of the KISS into Conversion Shares may require the Investor's execution of certain agreements relating to the purchase and sale of such securities as well as registration, co-sale, rights of first refusal, rights of first offer and voting rights, if any, relating to such securities. The

Investor agrees to execute all such agreements in connection with the conversion so long as the issuance of Conversion Shares issued pursuant to the conversion of this KISS are subject to the same terms and conditions applicable to the Preferred Stock sold in the Next Equity Financing (or the Shadow Series or Series Seed Preferred Stock, as applicable).

5.10 Severability. If one or more provisions of this KISS are held to be unenforceable under applicable law, such provision shall be excluded from this KISS and the balance of the KISS shall be interpreted as if such provision were so excluded and shall be enforceable in accordance with its terms.

5.11 Acknowledgement. For the avoidance of doubt, it is acknowledged that the Investor shall be entitled to the benefit of all adjustments in the number of shares of Common Stock of the Company issuable upon conversion of the Preferred Stock of the Company or as a result of any splits, recapitalizations, combinations or other similar transaction affecting the Common Stock or Preferred Stock underlying the Conversion Shares that occur prior to the conversion of the KISS.

5.12 Further Assurance. From time to time, the Company shall execute and deliver to the Investor such additional documents and shall provide such additional information to the Investor as the Investor may reasonably require to carry out the terms of this KISS and to be informed of the financial and business conditions and prospects of the Company.

5.13 Transfer of a KISS. Subject to compliance with applicable federal and state securities laws, this KISS and all rights hereunder are transferable in whole or in part by the Investor to any person or entity upon written notice to the Company.

5.14 Entire Agreement; Amendments and Waivers. This KISS and the other KISSes in the Series constitute the full and entire understanding and agreement between the parties with regard to the subjects hereof. The Company's agreements with each Holder are separate agreements, and the sales of the KISSes to each Holder are separate sales. Nonetheless, any term of the KISSes in the Series may be amended and the observance of any term of the KISSes in the Series may be waived (either generally or in a particular instance and either retroactively or prospectively), with the written consent of the Company and the Majority in Interest; provided, however, that Sections 2.2, 5.2 (if and only if Investor is a Major Investor), 5.3, 5.6, 5.13 and 5.14 may not be amended or waived without the written consent of the Investor. Any waiver or amendment effected in accordance with this Section 5.14 shall be binding upon the Company and each current and future member of the KISS Group.

5.15 Exculpation Among Holders. Each Holder acknowledges that it is not relying upon any person, firm, corporation or stockholder, other than the Company and its officers and directors in their capacities as such, in making its investment or decision to invest in the Company. Each Holder agrees that no other Holder nor the respective controlling persons, officers, directors, partners, agents, stockholders or employees of any other Holder shall be liable for any action heretofore or hereafter taken or omitted to be taken by any of them in connection with the purchase and sale of the KISSes.

[*Signature Page Follows*]

6. Approval. The Company hereby represents that its Board of Directors, in the exercise of its fiduciary duty, has approved the Company's execution of this KISS based upon a reasonable belief that the Purchase Price provided hereunder is appropriate for the Company after reasonable inquiry concerning the Company's financing objectives and financial situation. In addition, the Company hereby represents that it intends to use the Purchase Price primarily for the operations of its business, and not for any personal, family or household purpose.

_____, **INC.**

By: _____

Name: _____

Title: _____

Address: _____

_____

ACKNOWLEDGED AND AGREED:

_____

By: _____

Name: _____

Title: _____

Address: _____

_____

THIS INSTRUMENT AND THE SECURITIES ISSUABLE UPON THE CONVERSION HEREOF HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED. THEY MAY NOT BE SOLD, OFFERED FOR SALE, PLEDGED, HYPOTHECATED, OR OTHERWISE TRANSFERRED EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT REGISTRATION IS NOT REQUIRED UNDER SUCH ACT OR UNLESS SOLD PURSUANT TO RULE 144 UNDER SUCH ACT.

SERIES [1]
KISS

"***Purchase Price***" $

"***Date of Issuance***" _____ __, 201_

For the Purchase Price, the receipt and sufficiency of which is hereby acknowledged, this KISS is issued on the Date of Issuance by _____, Inc., a Delaware corporation (the "***Company***"), to _____ (the "***Investor***"). This KISS is one of a series of Series [1] KISSes issued by the Company to investors with identical terms and on the same form as set forth herein (except that the Investor, Purchase Price and Date of Issuance may differ in each KISS) (collectively, the "***Series***").

1. Definitions.

(a) "***Conversion Shares***" shall mean:

(i) with respect to a conversion pursuant to Section 2.1, shares of the Company's Preferred Stock issued in the Next Equity Financing; provided, however, that, at the Company's election, "Conversion Shares" with respect to a conversion pursuant to Section 2.1 shall mean shares of a Shadow Series;

(ii) with respect to a conversion pursuant to Section 2.2, shares of the Company's Common Stock; and

(iii) with respect to a conversion pursuant to Section 2.3, shares of a newly created series of the Company's Series Seed Preferred Stock, upon the terms and provisions set forth in the most recent version of the Series Seed documents posted at www.seriesseed.com (or if not so posted, as reasonably agreed by the Company and a Majority in Interest); provided that, for the avoidance of doubt, the Conversion Price shall be determined pursuant to Section 1(b)(iii).

(b) "***Conversion Price***" shall equal:

(i) with respect to a conversion pursuant to Section 2.1, the lower of (A) the product of (1) one (1) *minus* the Discount and (2) the price paid per share for Preferred Stock by the investors in the Next Equity Financing or (B) the quotient resulting from dividing

(1) the Valuation Cap by (2) the Fully-Diluted Capitalization immediately prior to the closing of the Next Equity Financing;

(ii) with respect to a conversion pursuant to Section 2.2, the quotient resulting from dividing (A) the Valuation Cap by (B) the Fully-Diluted Capitalization immediately prior to the closing of the Corporate Transaction; and

(iii) with respect to a conversion pursuant to Section 2.3, the quotient resulting from dividing (A) the Valuation Cap by (B) the Fully-Diluted Capitalization immediately prior to the conversion.

(c) "***Corporate Transaction***" shall mean (i) the closing of the sale, transfer or other disposition of all or substantially all of the Company's assets, (ii) the consummation of the merger or consolidation of the Company with or into another entity (except a merger or consolidation in which the holders of capital stock of the Company immediately prior to such merger or consolidation continue to hold at least 50% of the voting power of the capital stock of the Company or the surviving or acquiring entity), (iii) the closing of the transfer (whether by merger, consolidation or otherwise), in one transaction or a series of related transactions, to a person or group of affiliated persons (other than an underwriter of the Company's securities), of the Company's securities if, after such closing, such person or group of affiliated persons would hold 50% or more of the outstanding voting stock of the Company (or the surviving or acquiring entity), or (iv) the liquidation, dissolution or winding up of the Company; provided, however, that a transaction shall not constitute a Corporate Transaction if its sole purpose is to change the state of the Company's incorporation or to create a holding company that will be owned in substantially the same proportions by the persons who held the Company's securities immediately prior to such transaction. Notwithstanding the prior sentence, the sale of shares of Preferred Stock in a bona fide financing transaction shall not be deemed a "Corporate Transaction."

(d) "***Corporate Transaction Payment***" shall mean an amount equal to two times (2X) the Purchase Price.

(e) "***Discount***" shall mean _____ percent (__%).

(f) "***Equity Securities***" shall mean the Company's Common Stock or Preferred Stock or any securities conferring the right to purchase the Company's Common Stock or Preferred Stock or securities convertible into, or exchangeable for (with or without additional consideration), the Company's Common Stock or Preferred Stock, except any security granted, issued and/or sold by the Company to any director, officer, employee or consultant of the Company in such capacity for the primary purpose of soliciting or retaining their services.

(g) "***Financial Statements***" shall mean an income statement, balance sheet, statement of stockholders' equity, and/or a statement of cash flows, in each case as of the end of (i) each of the first three (3) fiscal quarters and (ii) each fiscal year of the Company.

(h) "***Fully-Diluted Capitalization***" shall mean the number of shares of outstanding Common Stock of the Company on a fully-diluted basis, including (i) conversion or exercise of all securities convertible into or exercisable for Common Stock, (ii) exercise of all

outstanding options and warrants to purchase Common Stock and, in the case of Section 1(b)(i) and 1(b)(iii) only, (iii) the shares reserved or authorized for issuance under the Company's existing stock option plan or any stock option plan created or increased in connection with such transaction; but excluding, for this purpose, the conversion contemplated by the applicable provision of Section 2.

(i) "***Holder***" shall mean a member of the KISS Group that holds a KISS (including, without limitation, the Investor, for so long as the Investor holds this KISS).

(j) "***KISS***" or "***KISSes***" shall mean the KISS instruments issued by the Company to Holders in the form hereof.

(k) "***KISS Group***" shall mean the holders of all KISSes in the Series, collectively.

(l) "***Majority in Interest***" shall mean members of the KISS Group holding a majority in interest of the aggregate Purchase Prices of all KISSes in the Series.

(m) "***Maturity Date***" shall mean the date that is eighteen (18) months following the Date of Issuance.

(n) "***Next Equity Financing***" shall mean the next sale (or series of related sales) by the Company of its Preferred Stock following the Date of Issuance from which the Company receives gross proceeds of not less than $1,000,000 (excluding the aggregate amount of securities converted into Preferred Stock in connection with such sale (or series of related sales)).

(o) "***Participation Amount***" shall mean an amount in US dollars equal to one times (1X) the Purchase Price.

(p) "***Shadow Series***" shall mean shares of a series of the Company's Preferred Stock that is identical in all respects to the shares of Preferred Stock issued in the Next Equity Financing (e.g., if the Company sells Series A Preferred Stock in the Next Equity Financing, the Shadow Series would be Series A-1 Preferred Stock), except that the liquidation preference per share of the Shadow Series shall equal the Conversion Price (as determined pursuant to Section 1(b)(i)), with corresponding adjustments to any price-based antidilution and dividend rights provisions.

(q) "***Valuation Cap***" shall mean US$__,000,000.

2. Conversion of the KISS.

2.1 Next Equity Financing. Upon the closing of the Next Equity Financing, this KISS will be automatically converted into that number of Conversion Shares equal to the quotient obtained by dividing the Purchase Price by the Conversion Price. At least five (5) days prior to the closing of the Next Equity Financing, the Company shall notify the Investor in writing of the terms under which the Preferred Stock of the Company will be sold in such financing. The issuance of Conversion Shares pursuant to the conversion of this KISS shall be

upon and subject to the same terms and conditions applicable to the Preferred Stock sold in the Next Equity Financing (or the Shadow Series, as applicable).

2.2 Corporate Transaction. In the event of a Corporate Transaction prior to the conversion of this KISS pursuant to Section 2.1 or 2.3, at Investor's election, (i) this KISS shall be converted into that number of Conversion Shares equal to the quotient obtained by dividing the Purchase Price by the Conversion Price; or (ii) the Investor shall be paid the Corporate Transaction Payment, prior and in preference to any distribution of any of the cash or other assets of the Company to holders of the Company's capital stock by reason of their ownership of such stock. At least ten (10) days prior to the closing of the Corporate Transaction, the Company shall notify the Investor in writing of the terms of the Corporate Transaction.

2.3 Maturity Conversion. Unless earlier converted to Conversion Shares or paid pursuant to Section 2.1 or 2.2, at the election of the Majority in Interest at any time on or after the Maturity Date, this KISS shall be converted into that number of Conversion Shares equal to the quotient obtained by dividing the Purchase Price by the Conversion Price.

2.4 No Fractional Shares. Upon the conversion of this KISS into Conversion Shares, in lieu of any fractional shares to which the holder of this KISS would otherwise be entitled, the Company shall pay the holder cash equal to such fraction multiplied by the Conversion Price.

2.5 Mechanics of Conversion. As promptly as practicable after the conversion of this KISS, the Company at its expense will issue and deliver to the Investor, upon surrender of this KISS, a certificate or certificates for the number of Conversion Shares. Conversion of this KISS may be made contingent upon the closing of the Next Equity Financing or Corporate Transaction.

3. Representations and Warranties of the Company. In connection with the transactions provided for herein, the Company hereby represents and warrants to the Investor that:

3.1 Organization, Good Standing and Qualification. The Company is a corporation duly organized, validly existing, and in good standing under the laws of the State of Delaware and has all requisite corporate power and authority to carry on its business as now conducted. The Company is duly qualified to transact business and is in good standing in each jurisdiction in which the failure to so qualify would have a material adverse effect on its business or properties.

3.2 Authorization. Except for the authorization and issuance of the Conversion Shares issuable in connection with the Next Equity Financing, a Corporate Transaction or an optional conversion on or after the Maturity Date, all corporate action has been taken on the part of the Company, its officers, directors and stockholders necessary for the authorization, execution and delivery of this KISS. The Company has taken all corporate action required to make all of the obligations of the Company reflected in the provisions of this KISS the valid and enforceable obligations they purport to be, and this KISS, when executed and

delivered by the Company, shall constitute the valid and legally binding obligation of the Company, enforceable against the Company in accordance with its terms.

3.3 Offering. Subject in part to the truth and accuracy of the Investor's representations set forth herein, the offer, sale and issuance of this KISS are exempt from the registration requirements of any applicable state and federal securities laws, and neither the Company nor any authorized agent acting on its behalf will take any action hereafter that would cause the loss of such exemption.

3.4 Compliance with Other Instruments. The execution, delivery and performance of this KISS, and the consummation of the transactions contemplated hereby, will not constitute or result in a default, violation, conflict or breach in any material respect of any provision of the Company's current Certificate of Incorporation or bylaws, or in any material respect of any instrument, judgment, order, writ, decree, privacy policy or contract to which it is a party or by which it is bound, or, to its knowledge, of any provision of any federal or state statute, rule or regulation applicable to the Company.

3.5 Valid Issuance of Stock. The Conversion Shares, when issued, sold and delivered upon conversion of this KISS, will be duly authorized and validly issued, fully paid and nonassessable, will be free of restrictions on transfer other than restrictions on transfer set forth herein and pursuant to applicable state and federal securities laws and, based in part upon the representations and warranties of the Investor herein, will be issued in compliance with all applicable federal and state securities laws.

3.6 Intellectual Property. To its knowledge, the Company owns or possesses or believes it can acquire on commercially reasonable terms sufficient legal rights to all patents, patent applications, trademarks, trademark applications, service marks, tradenames, copyrights, trade secrets, licenses, domain names, mask works, information and proprietary rights and processes as are necessary to the conduct of its business as now conducted and as presently proposed to be conducted without any known conflict with, or infringement of, the rights of others. The Company has not received any communications alleging that the Company has violated or, by conducting its business, would violate any of the patents, trademarks, service marks, tradenames, copyrights, trade secrets, mask works or other proprietary rights or processes of any other person.

3.7 Litigation. To the Company's knowledge, there is no private or governmental action, suit, proceeding, claim, arbitration or investigation pending before any agency, court or tribunal, foreign or domestic, or threatened against the Company or any of its properties or any of its officers or managers (in their capacities as such). There is no judgment, decree or order against the Company, or, to the knowledge of the Company, any of its directors or managers (in their capacities as such), that could prevent, enjoin, or materially alter or delay any of the transactions contemplated by this KISS, or that could reasonably be expected to have a material adverse effect on the Company.

4. Representations and Warranties of the Investor. In connection with the transactions provided for herein, the Investor hereby represents and warrants to the Company that:

4.1 Authorization. This KISS constitutes Investor's valid and legally binding obligation, enforceable in accordance with its terms, except as may be limited by (i) applicable bankruptcy, insolvency, reorganization, or similar laws relating to or affecting the enforcement of creditors' rights and (ii) laws relating to the availability of specific performance, injunctive relief or other equitable remedies.

4.2 Purchase Entirely for Own Account. Investor acknowledges that this KISS is issued to Investor in reliance upon Investor's representation to the Company that the KISS will be acquired for investment for Investor's own account, not as a nominee or agent, and not with a view to the resale or distribution of any part thereof, and that such Investor has no present intention of selling, granting any participation in, or otherwise distributing the same.

4.3 Investment Experience. Investor is an investor in securities of companies in the development stage and acknowledges that it is able to fend for itself, can bear the economic risk of its investment, and has such knowledge and experience in financial or business matters that it is capable of evaluating the merits and risks of the investment in this KISS. Investor also represents it has not been organized solely for the purpose of acquiring this KISS.

4.4 Accredited Investor. Investor is an "accredited investor" within the meaning of Rule 501 of Regulation D, as presently in effect, as promulgated by the Securities and Exchange Commission (the "***SEC***") under the Securities Act of 1933, as amended (the "***Act***").

4.5 Restricted Security. Investor understands that this KISS is characterized as a "restricted security" under the federal securities laws inasmuch as it is being acquired from the Company in a transaction not involving a public offering and that under such laws and applicable regulations such securities may be resold without registration under the Act, only in certain limited circumstances.

5. Miscellaneous.

5.1 Most Favored Nation. In the event the Company sells or issues any convertible instruments (other than the issuance of stock options to service providers of the Company) at any time prior to the earlier of (a) conversion of this KISS or (b) a Corporate Transaction, the Company shall provide the Investor with written notice of such sale or issuance no later than five (5) days after the closing date thereof, including the price and terms of such convertible instruments (the "***Subsequent Instruments***"). In the event the Investor determines, in its sole and absolute discretion, that any Subsequent Instrument contains terms more favorable to the holder(s) thereof than the terms set forth in this KISS, the Investor may elect to exchange this KISS for a Subsequent Instrument.

5.2 Major Investor Rights. In the event the Investor, together with its affiliates, purchases one or more KISSes with an aggregate Purchase Price equal to or exceeding $50,000 (a "***Major Investor***"), the Company shall provide such Major Investor with the following rights:

(a) Information Rights. To the extent that the Company prepares Financial Statements, the Company shall deliver to the Major Investor such Financial Statements

upon request, as soon as practicable, but in any event within thirty (30) days after the end of each of the first three (3) quarters of each fiscal year of the Company and within ninety (90) days after the end of each fiscal year of the Company. Such Financial Statements shall be in reasonable detail and prepared on a consistent basis. Additionally, regardless of whether the Company prepares Financial Statements, the Company shall deliver to the Major Investor such information relating to the financial condition, business or corporate affairs of the Company as such Major Investor may from time to time reasonably request. Notwithstanding anything to the contrary in this Section 5.2(a), the Company shall not be obligated under this Section 5.2(a) to provide information that (x) it deems in good faith to be a trade secret or highly confidential information or (y) the disclosure of which would adversely affect the attorney-client privilege between the Company and its counsel; and the Investor agrees to maintain the confidentiality of all of the information provided to the Investor under this Section 5.2(a) and agrees not to use such information other than for a purpose reasonably related to the Investor's investment in the Company.

(b) Participation Rights. Each time the Company proposes to offer any Equity Securities at any time through and including the closing of the Next Equity Financing, the Company shall provide the Major Investor with at least ten (10) business days prior written notice of such offering, including the price and terms thereof. The Major Investor shall have a right of first offer to participate in such offering(s), on the same terms and for the same price as all other investors in such offering(s), by purchasing an aggregate number of Equity Securities (whether in one offering or across multiple offerings) valued at up to the Participation Amount. The Major Investor's right of first offer set forth in this Section 5.2(b) shall be subject to compliance with applicable federal and state securities laws.

(c) "Major Investor" Rights. The Company shall ensure that the Major Investor shall be deemed to be a "Major Investor" (or such similar term) for all purposes, including, without limitation, rights of first offer and information rights, in relevant financing documents related to all subsequent sales of Equity Securities, to the extent such concept exists.

5.3 Payment. All payments, if any, shall be made in lawful money of the United States of America. Payment shall be credited first to Costs (as defined below), if any, then to the Corporate Transaction Payment. The Company hereby waives demand, notice, presentment, protest and notice of dishonor.

5.4 Costs, Expenses and Attorneys' Fees; Indemnity. The Company hereby agrees, subject only to any limitation imposed by applicable law, to pay all expenses, including reasonable attorneys' fees and legal expenses, incurred by the holder of this KISS in endeavoring to collect any amounts payable hereunder which are not paid when due, whether by declaration or otherwise ("***Costs***"). The Company agrees that any delay on the part of the holder in exercising any rights hereunder will not operate as a waiver of such rights. The holder of this KISS shall not by any act, delay, omission or otherwise be deemed to have waived any of its rights or remedies, and no waiver of any kind shall be valid unless in writing and signed by the party or parties waiving such rights or remedies. If any action at law or in equity is necessary to enforce or interpret the terms of this KISS, the prevailing party shall be entitled to reasonable attorneys' fees, costs and necessary disbursements in addition to any other relief to which such party may be entitled. The Company shall indemnify and hold the Investor harmless from any

loss, cost, liability and legal or other expense, including attorneys' fees of the Investor's counsel, which the Investor may directly or indirectly suffer or incur by reason of the failure of the Company to perform any of its obligations under this KISS or any agreement executed in connection herewith; provided, however, that the indemnity agreement contained in this Section 5.4 shall not apply to liabilities which the Investor may directly or indirectly suffer or incur by reason of the Investor's own gross negligence or willful misconduct.

5.5 Successors and Assigns. The terms and conditions of this KISS shall inure to the benefit of and be binding upon the respective successors and assigns of the parties hereto; provided, however, that the Company may not assign its obligations under this KISS without the prior written consent of the Investor.

5.6 Governing Law. This KISS shall be governed by and construed under the laws of the State of California as applied to other instruments made by California residents to be performed entirely within the State of California, regardless of the laws that might otherwise govern under applicable principles of conflicts of law.

5.7 Notices. All notices and other communications given or made pursuant to this KISS shall be in writing and shall be deemed effectively given upon the earlier of actual receipt or: (a) personal delivery to the party to be notified, (b) when sent, if sent by electronic mail or facsimile during normal business hours of the recipient, and if not sent during normal business hours, then on the recipient's next business day, (c) five (5) days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (d) one (1) business day after deposit with a nationally recognized overnight courier, freight prepaid, specifying next business day delivery, with written verification of receipt.

5.8 Financing Agreements. The Investor understands and agrees that the conversion of the KISS into Conversion Shares may require the Investor's execution of certain agreements relating to the purchase and sale of such securities as well as registration, co-sale, rights of first refusal, rights of first offer and voting rights, if any, relating to such securities. The Investor agrees to execute all such agreements in connection with the conversion so long as the issuance of Conversion Shares issued pursuant to the conversion of this KISS are subject to the same terms and conditions applicable to the Preferred Stock sold in the Next Equity Financing (or the Shadow Series or Series Seed Preferred Stock, as applicable).

5.9 Severability. If one or more provisions of this KISS are held to be unenforceable under applicable law, such provision shall be excluded from this KISS and the balance of the KISS shall be interpreted as if such provision were so excluded and shall be enforceable in accordance with its terms.

5.10 Acknowledgement. For the avoidance of doubt, it is acknowledged that the Investor shall be entitled to the benefit of all adjustments in the number of shares of Common Stock of the Company issuable upon conversion of the Preferred Stock of the Company or as a result of any splits, recapitalizations, combinations or other similar transaction affecting the Common Stock or Preferred Stock underlying the Conversion Shares that occur prior to the conversion of the KISS.

5.11 Further Assurance. From time to time, the Company shall execute and deliver to the Investor such additional documents and shall provide such additional information to the Investor as the Investor may reasonably require to carry out the terms of this KISS and to be informed of the financial and business conditions and prospects of the Company.

5.12 Transfer of a KISS. Subject to compliance with applicable federal and state securities laws, this KISS and all rights hereunder are transferable in whole or in part by the Investor to any person or entity upon written notice to the Company.

5.13 Entire Agreement; Amendments and Waivers. This KISS and the other KISSes in the Series constitute the full and entire understanding and agreement between the parties with regard to the subjects hereof. The Company's agreements with each Holder are separate agreements, and the sales of the KISSes to each Holder are separate sales. Nonetheless, any term of the KISSes in the Series may be amended and the observance of any term of the KISSes in the Series may be waived (either generally or in a particular instance and either retroactively or prospectively), with the written consent of the Company and the Majority in Interest; provided, however, that Sections 2.2, 5.2 (if and only if Investor is a Major Investor), 5.3, 5.5, 5.12 and 5.13 may not be amended or waived without the written consent of the Investor. Any waiver or amendment effected in accordance with this Section 5.13 shall be binding upon the Company and each current and future member of the KISS Group.

5.14 Priority. This KISS shall rank pari passu in all respects (including right of payment) to all other KISSes and all convertible indebtedness of the Company, now or hereafter existing.

5.15 Exculpation Among Holders. Each Holder acknowledges that it is not relying upon any person, firm, corporation or stockholder, other than the Company and its officers and directors in their capacities as such, in making its investment or decision to invest in the Company. Each Holder agrees that no other Holder nor the respective controlling persons, officers, directors, partners, agents, stockholders or employees of any other Holder shall be liable for any action heretofore or hereafter taken or omitted to be taken by any of them in connection with the purchase and sale of the KISSes.

[*Signature Page Follows*]

6. Approval. The Company hereby represents that its Board of Directors, in the exercise of its fiduciary duty, has approved the Company's execution of this KISS based upon a reasonable belief that the Purchase Price provided hereunder is appropriate for the Company after reasonable inquiry concerning the Company's financing objectives and financial situation. In addition, the Company hereby represents that it intends to use the Purchase Price primarily for the operations of its business, and not for any personal, family or household purpose.

_____, INC.

By: _____

Name: _____

Title: _____

Address: _____

_____

ACKNOWLEDGED AND AGREED:

_____

By: _____

Name: _____

Title: _____

Address: _____

_____

NOTICE TO RESIDENTS OF THE UNITED STATES

THE OFFER AND SALE OF THIS SECURITY INSTRUMENT HAS NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "***SECURITIES ACT***"), OR UNDER THE SECURITIES LAWS OF CERTAIN STATES. THIS SECURITY MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED, PLEDGED OR HYPOTHECATED EXCEPT AS PERMITTED UNDER THE ACT AND APPLICABLE STATE SECURITIES LAWS PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT OR AN EXEMPTION THEREFROM.

[International legends to be updated as appropriate for the offering]

NOTICE TO RESIDENTS OF CANADA

UNLESS PERMITTED UNDER SECURITIES LEGISLATION, THE HOLDER OF THIS SECURITY MUST NOT TRADE THE SECURITY BEFORE THE DATE THAT THE ISSUER BECOMES A REPORTING ISSUER IN ANY PROVINCE OR TERRITORY.

NOTICE TO RESIDENTS OF CHINA

THE RIGHTS ARE NOT BEING OFFERED OR SOLD AND MAY NOT BE OFFERED OR SOLD, DIRECTLY OR INDIRECTLY, WITHIN THE PEOPLE'S REPUBLIC OF CHINA (FOR SUCH PURPOSES, NOT INCLUDING THE HONG KONG AND MACAU SPECIAL ADMINISTRATIVE REGIONS OR TAIWAN), EXCEPT AS PERMITTED BY THE SECURITIES AND OTHER LAWS AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA

NOTICE TO RESIDENTS OF THE UNITED KINGDOM

IN THE UNITED KINGDOM THIS DOCUMENT IS BEING DISTRIBUTED ONLY TO, AND IS DIRECTED ONLY AT (AND ANY INVESTMENT ACTIVITY TO WHICH IT RELATES WILL BE ENGAGED ONLY WITH): (i) INVESTMENT PROFESSIONALS (WITHIN THE MEANING OF ARTICLE 19(5) OF THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL PROMOTION) ORDER 2005 AS AMENDED (THE "***FPO***")); (ii) PERSONS OR ENTITIES OF A KIND DESCRIBED IN ARTICLE 49 OF THE FPO; (iii) CERTIFIED SOPHISTICATED INVESTORS (WITHIN THE MEANING OF ARTICLE 50(1) OF THE FPO); AND (iv) OTHER PERSONS TO WHOM IT MAY OTHERWISE LAWFULLY BE COMMUNICATED (ALL SUCH PERSONS TOGETHER BEING REFERRED TO AS "RELEVANT PERSONS").

THIS DOCUMENT HAS NOT BEEN APPROVED BY AN AUTHORISED PERSON. ANY INVESTMENT TO WHICH THIS DOCUMENT RELATES IS AVAILABLE ONLY TO (AND ANY INVESTMENT ACTIVITY TO WHICH IT RELATES WILL BE ENGAGED ONLY WITH) RELEVANT PERSONS. THIS DOCUMENT IS DIRECTED ONLY AT RELEVANT PERSONS AND PERSONS WHO ARE NOT RELEVANT PERSONS SHOULD NOT TAKE ANY ACTION BASED UPON THIS DOCUMENT AND SHOULD NOT RELY ON IT. IT IS A CONDITION OF

YOU RECEIVING AND RETAINING THIS DOCUMENT THAT YOU WARRANT TO THE COMPANY, ITS DIRECTORS, AND ITS OFFICERS THAT YOU ARE A RELEVANT PERSON.

[TOKEN NAME], a product of [**COMPANY NAME**]

SAFT
(Simple Agreement for Future Tokens)

THIS CERTIFIES THAT in exchange for the payment by the undersigned purchaser (the "***Purchaser***") of $[_____] (the "***Purchase Amount***") on or about [DATE], 2017, [Company Name], a [State of Incorporation] corporation (the "**Company**"), hereby issues to the Purchaser the right (the "***Right***") to certain units of [Token Name] (the "***Token***" or "***[Token Name]***"), subject to the terms set forth below.

1. *Events*

(a) **Network Launch**. If there is a Network Launch before the expiration or termination of this instrument, the Company will automatically issue to the Purchaser a number of units of the Token equal to the Purchase Amount divided by the Discount Price.

In connection with and prior to the issuance of Tokens by the Company to the Purchaser pursuant to this Section 1(a):

(i) The Purchaser will execute and deliver to the Company any and all other transaction documents related to this SAFT, including verification of accredited investor status or non-U.S. person status under the applicable securities laws; and

(ii) The Purchaser will provide to the Company a network address for which to allocate Purchaser's Tokens upon the Network Launch.

(b) **Dissolution Event**. If there is a Dissolution Event before this instrument expires or terminates, the Company will pay an amount equal to the Purchase Amount multiplied by the Discount Rate (the "***Discounted Purchase Amount***"), due and payable to the Purchaser immediately prior to, or concurrent with, the consummation of the Dissolution Event[, subject to the rights and preferences of the holders of the Company's preferred stock, as set forth in the Company's Certificate of Incorporation, as it may be amended from time to time.][1] If immediately prior to the consummation of the Dissolution Event, the assets of the Company that remain legally available for distribution to the Purchaser and all holders of all other SAFTs (the "***Dissolving Purchasers***"), as determined in good faith by the Company's board of directors, are insufficient to permit the payment to the Dissolving Purchasers of their respective Discounted Purchase Amounts, then the remaining assets of the Company legally available for distribution, following all distributions to the holders of the Company's preferred stock, will be distributed with equal priority and pro rata among the Dissolving Purchasers in proportion to the

[1] Review Company's Certificate of Incorporation for liquidation preferences of preferred stockholders if any series of preferred stock is issued and outstanding.

Discounted Purchase Amounts they would otherwise be entitled to receive pursuant to this Section 1(b). Any distributed amounts shall be in U.S. Dollars.

(c) **Termination**. This instrument will expire and terminate upon the earlier of (i) the issuance of Tokens to the Purchaser pursuant to Section 1(a); (ii) the payment, or setting aside for payment, of amounts due the Purchaser pursuant to Section 1(b); (iii) [DATE] (the "***Deadline Date***"), if the Network Launch has not occurred as of such date; provided that, the Company shall have the right to extend the Deadline Date by sixty (60) days, in its sole discretion[; and (iv) the failure to obtain net proceeds of more than $[_____] from the sale of all rights pursuant to the SAFTs; *provided*, that in the case of (iv), the Company shall have the obligation to repay to the Purchasers the aggregate amount of all Purchase Amounts.][2]

2. ***Definitions***

"***Discount Price***" means the maximum price per Token sold by the Company to the public during the Network Launch multiplied by the Discount Rate.

"***Discount Rate***" is [__%].

"***Dissolution Event***" means (i) a voluntary termination of operations of the Company, (ii) a general assignment for the benefit of the Company's creditors or (iii) any other liquidation, dissolution or winding up of the Company, whether voluntary or involuntary.

"***Network Launch***" means [a *bona fide* transaction or series of transactions, pursuant to which the Company will sell the Tokens to the general public in a publicized product launch.][3]

"***SAFT***" means an agreement containing a future right to units of Tokens purchased by Purchasers, similar in form and content to this agreement, which a significant portion of the amount raised under the SAFTs will be used to fund the Company's development of a decentralized blockchain-based computer network (the "***[Network]***") that enables [describe the end goal, function and utility of the proposed Network].

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[2] Include if there will be a minimum offering amount.
[3] Customize to the launch event the Company anticipates.

3. ***Company Representations***

(a) The Company is a corporation duly organized, validly existing and in good standing under the laws of [STATE], and has the power and authority to own, lease and operate its properties and carry on its business as now conducted.

(b) The execution, delivery and performance by the Company of this instrument is within the power of the Company and, other than with respect to the actions to be taken when Tokens are to be issued to the Purchaser, has been duly authorized by all necessary actions on the part of the Company. This instrument constitutes a legal, valid and binding obligation of the Company, enforceable against the Company in accordance with its terms, except as limited by bankruptcy, insolvency or other laws of general application relating to or affecting the enforcement of creditors' rights generally and general principles of equity. To the knowledge of the Company, it is not in violation of (i) its current articles of incorporation or bylaws, (ii) any material statute, rule or regulation applicable to the Company, or (iii) any material indenture or contract to which the Company is a party or by which it is bound, where, in each case, such violation or default, individually, or together with all such violations or defaults, could reasonably be expected to have a material adverse effect on the Company.

(c) To the knowledge of the Company, the performance and consummation of the transactions contemplated by this instrument do not and will not: (i) violate any material judgment, statute, rule or regulation applicable to the Company; (ii) result in the acceleration of any material indenture or contract to which the Company is a party or by which it is bound; or (iii) result in the creation or imposition of any lien upon any property, asset or revenue of the Company or the suspension, forfeiture, or nonrenewal of any material permit, license or authorization applicable to the Company, its business or operations.

(d) No consents or approvals are required in connection with the performance of this instrument, other than: (i) the Company's corporate approvals; and (ii) any qualifications or filings under applicable securities laws.

(e) To its knowledge, the Company owns or possesses (or can obtain on commercially reasonable terms) sufficient legal rights to all patents, trademarks, service marks, trade names, copyrights, trade secrets, licenses, information, processes and other intellectual property rights necessary for its business as now conducted and as currently proposed to be conducted, without an infringement of the rights of others. [Token name] is not a proprietary trade name of the Company.[4]

4. ***Purchaser Representations***

(a) The Purchaser has full legal capacity, power and authority to execute and deliver this instrument and to perform its obligations hereunder. This instrument constitutes valid and binding obligation of the Purchaser, enforceable in accordance with its terms, except as limited

[4] Review with IP counsel.

by bankruptcy, insolvency or other laws of general application relating to or affecting the enforcement of creditors' rights generally and general principles of equity.

(b) The Purchaser has been advised that this instrument is a security and that the offers and sales of this instrument have not been registered under any country's securities laws and, therefore, cannot be resold except in compliance with the applicable country's laws. The Purchaser is purchasing this instrument for its own account for investment, not as a nominee or agent, and not with a view to, or for resale in connection with, the distribution thereof, and the Purchaser has no present intention of selling, granting any participation in, or otherwise distributing the same. The Purchaser has such knowledge and experience in financial and business matters that the Purchaser is capable of evaluating the merits and risks of such investment, is able to incur a complete loss of such investment without impairing the Purchaser's financial condition and is able to bear the economic risk of such investment for an indefinite period of time.

(c) The Purchaser enters into this SAFT with the predominant expectation that he, she or it, as the case may be, will profit upon the successful development and Network Launch arising from the efforts of the Company and its employees to develop and market the [Network] and the [Network Launch] and related sale of the Tokens.

5. ***Procedures for Purchase of Rights and Valuation of Purchase Amount.***

(a) The Company will accept payment for the Right purchased under this SAFT in [U.S. Dollars/Bitcoin/Ether]. Purchaser shall make the required payment to the Company in consideration for Purchaser's purchase of the Right pursuant to the SAFT through the procedures set forth on *Exhibit A* hereof.

(b) For purposes of this instrument, the value of the Purchase Amount shall be deemed in [Ether] whether the Purchaser pays in [U.S. Dollars/Bitcoin/[or] Ether], valued at the Applicable Exchange Rate for [Ether]. The term "***Applicable Exchange Rate***" shall mean the volume-weighted average daily price of [Ether] [across/on] [exchange(s)/index(es)] in the 24-hour period (Eastern Time) following the day and time that the Company notifies the Purchaser, in writing, that the Company has accepted Purchaser's offer to purchase the Right under this SAFT.[5]

6. ***Miscellaneous***

(a) This instrument sets forth the entire agreement and understanding of the parties relating to the subject matter herein and supersedes all prior or contemporaneous disclosures, discussions, understandings and agreements, whether oral of written, between them. This instrument is one of a series of similar instruments entered into by the Company from time to time. Any provision of this instrument may be amended, waived or modified only upon the written consent of the Company and the holders of a majority, in the aggregate, of the Purchase

[5] Update based on the types of digital assets or fiat currency Company will accept for the SAFTs.

Amounts paid to the Company with respect to all SAFTs outstanding at the time of such amendment, waiver or modification.

(b) Any notice required or permitted by this instrument will be deemed sufficient when sent by email to the relevant address listed on the signature page, as subsequently modified by written notice received by the appropriate party.

(c) The Purchaser is not entitled, as a holder of this instrument, to vote or receive dividends or be deemed the holder of capital stock of the Company for any purpose, nor will anything contained herein be construed to confer on the Purchaser, as such, any of the rights of a stockholder of the Company or any right to vote for the election of directors or upon any matter submitted to stockholders at any meeting thereof, or to give or withhold consent to any corporate action or to receive notice of meetings, or to receive subscription rights or otherwise.

(d) Neither this instrument nor the rights contained herein may be assigned, by operation of law or otherwise, by either party without the prior written consent of the other; *provided, however*, that this instrument and/or the rights contained herein may be assigned without the Company's consent by the Purchaser to any other entity who directly or indirectly, controls, is controlled by or is under common control with the Purchaser, including, without limitation, any general partner, managing member, officer or director of the Purchaser, or any venture capital fund now or hereafter existing which is controlled by one or more general partners or managing members of, or shares the same management company with, the Purchaser; and *provided, further*, that the Company may assign this instrument in whole, without the consent of the Purchaser, in connection with a reincorporation to change the Company's domicile.

(e) In the event any one or more of the provisions of this instrument is for any reason held to be invalid, illegal or unenforceable, in whole or in part or in any respect, or in the event that any one or more of the provisions of this instrument operate or would prospectively operate to invalidate this instrument, then and in any such event, such provision(s) only will be deemed null and void and will not affect any other provision of this instrument and the remaining provisions of this instrument will remain operative and in full force and effect and will not be affected, prejudiced, or disturbed thereby.

(f) All rights and obligations hereunder will be governed by the laws of [_____], without regard to the conflicts of law provisions of such jurisdiction.

(*Signature page follows*)

IN WITNESS WHEREOF, the undersigned have caused this instrument to be duly executed and delivered.

[Company]

By:_____
[Name]
[Title]

Address:

_____

_____

Email:

PURCHASER:

By:_____

Name: _____

Title:_____

Email:_____

Exhibit A

Cybersecurity Update

Richard L. Chen
rich@richardlchen.com

A User-Friendly Guide on How to Conduct a Cybersecurity Risk Assessment

Why is this important for venture capital funds?

- Must protect fund investor information
- Must protect firm strategy information
- Must ensure portfolio companies are not subject of catastrophic cybersecurity breach

SEC Guidance and Enforcement

February 3, 2015 SEC Risk Alert on Cybersecurity

http://www.sec.gov/ocie/announcement/Cybersecurity-Risk-Alert--Appendix---4.15.14.pdf

SEC Guidance and Enforcement

August 7, 2017 SEC Risk Alert - Observations from Cybersecurity Examinations

https://www.sec.gov/files/observations-from-cybersecurity-examinations.pdf

SEC Guidance and Enforcement

April 16, 2019 SEC Risk Alert on Common Regulation S-P Violations

https://www.sec.gov/ocie/announcement/ocie-risk-alert-regulation-s-p

SEC Guidance and Enforcement

Enforcement Action Against R.T. Jones Capital Equity Management, Inc.

https://www.sec.gov/litigation/admin/2015/ia-4204.pdf

The 5 Ws for Analyzing Cybersecurity Risk

- **what information must be protected**
- **where is such information**
- **who has access to such information**
- **what threats does a firm face with respect to its information**
- **what measures have been adopted to protect such information**