

SPOTLIGHT ON TOKEN DUE DILIGENCE

The Key Aspects of Conducting Token Due Diligence

A Spotlight on a Comprehensive
Approach to Navigating US Token
Due Diligence



RISK | STRATEGY | CYBER COMPLIANCE MANAGEMENT



The Key Aspects of Token Due Diligence

Conducting thorough token due diligence (TDD) involves a deep dive beyond just analyzing historical data or predictions. Rather, it means exploring the intricacies of technology, evaluating security measures, understanding liquidity factors, navigating complex regulations, and more. Moreover, TDD encompasses a range of factors, including regulatory compliance, technological stability, and market behavior, to ensure that the token aligns with legal and financial standards.

1 REGULATORY COMPLIANCE

Ensure the token adheres to relevant securities laws and regulations. This includes evaluating its classification under the Howey Test to determine if it qualifies as a security.



4 SECURITY MEASURES

Review the security protocols to protect against fraud and hacking. Evaluate the measures in place to safeguard investor funds and ensure transaction integrity.



2 TECHNOLOGICAL EVALUATION

Assess the blockchain technology for security and scalability and evaluate the code for vulnerabilities. Review the governance model for transparency and robustness.



5 TEAM AND PROJECT VIABILITY

Investigate the credibility and experience of the development team. Evaluate the feasibility and potential impact of the token project on its intended market.



3 MARKET ANALYSIS

Analyze the token's market performance, liquidity, and adoption rates. Assess financial models and projections to understand potential returns on investment and associated risks.



6 OPERATIONAL RISK

Assess the risks associated with token issuance, distribution, and management. Review policies for handling regulatory changes and potential market disruptions to ensure comprehensive risk management.



The Howey Test

The Howey Test, established by the US Supreme Court, is crucial in determining whether a digital asset qualifies as a security. This test is essential for TDD as it helps identify the regulatory requirements applicable to the digital asset, influencing how it can be legally offered and sold. The Howey Test assesses the following components:

Expectation of Profits

Is there a reasonable expectation of profits or financial returns or is there capital appreciation due to development of the initial investment?



Investment of Money

Is the digital asset purchased or acquired in exchange for value, whether in a form of real or fiat currency, another digital asset or others?



Efforts of Others

Does the purchaser reasonably rely on the efforts of a promoter, sponsor or other third party, each an “Active Participant,” and are those efforts significant enough to impact the success or failure of the enterprise?



Common Enterprise

Is there a presence of “horizontal commonality” or the tying of individual investor’s fortunes to those of other investors in a pool of assets with pro-rated profit distribution or a presence of “vertical commonality” which focuses on the relationship between the promoter and the body of investors?



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Token Due Diligence Listing and Monitoring

Transactions with virtual currency or digital assets pose risks such as regulatory uncertainties, fraud, and technological vulnerabilities. Stratis can assist you by providing comprehensive token due diligence reviews to further understand a token's functionality, identify legal and regulatory risks, and whether a token may be classified as a security under the Howey Test.



Money Transmitter Registration and Licensing

Engaging in virtual currency activity may require registering as a money services business (MSB) and achieving money transmitter licenses with more than 45+ US states depending on the business model. For more than 10 years, Stratis has helped startups to Fortune-ranked companies launch, scale, and optimize digital asset business models. Stratis can help you execute and maintain a licensing program, inclusive of New York-specific requirements, to successfully operate in market and maintain banking partnerships.



Outsourced Regulatory Monitoring Program

Operating domestically or globally, industry guidance and laws and regulations are evolving and expanding, specifically those on beneficial ownership reporting, data privacy and breach reporting, cybersecurity program implementation, and third-party risk management. Stratis can develop and execute a customized outsourced regulatory monitoring program based on your operating model, markets, customers, and risk tolerance to proactively address relevant changes that impact your business.





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