



## Digital Securities 101

### What is a Security?

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### What is a Digital Security?

A digital security is a smart contract deployed to a blockchain that records and represents a fungible, negotiable financial instrument representing some type of financial value, usually in the form of a stock, bond, or option (equity, debt or futures), and backed by established legal and regulatory frameworks. A digital security takes the best qualities of an ICO (Initial Coin Offering) and an IPO (Initial Public Offering), providing IPO-type protections within a cryptographic asset, ensuring investor protections with KYC-AML compliance and regulatory oversight. It maximizes the issue-investor alignment, creating investor liquidity, and giving founders access to a broader investor community. Digital securities allow stakeholders to control virtually all aspects of their ownership programmatically.

### I lost my digital securities!

Digital securities cannot be lost by investors, even without the use of custodial services. If investors lose access to their tokens, a request to the issuer is made to burn/destroy the lost tokens, and to re-issue new ones to a new wallet held by the investor. Unlike cryptocurrencies and most utility tokens working in a decentralized way, digital securities are issued by a single legal entity that is responsible for the proper management of the securities.

### What if I don't want tokens? I want paper shares.

We don't know of a valid reason why anyone wouldn't want all of the additional investor benefits and protections of a digital security, but in that event, the issuer would custody the digital version of the shares and the investor can proceed as usual.

### Can anyone pump and dump my digital securities?

Yes and no, but mostly no. There are many ways to prevent this; four of them are: 1) offer only a small portion of shares for sale, 2) limit the number of shares any one entity can own, 3) limit the number of shares any one entity can trade in a certain period, 4) provide substantial dividends to incentivize



holding. All of these benefits (and more) can be easily programmed into the digital security. Keep in mind restricting tokens will likely have a negative impact on their value.

## **Can anyone influence the price/valuation of the company once the tokens are on an exchange?**

Yes and no, but mostly no. In a small market (e.g. \$25-50,000 in daily trading) where only a small amount of shares are traded (e.g. 5-10%) - which is where most issuers will start - sophisticated investors will know the exchange-traded prices will simply not reflect the true value of all shares.

## **I'm worried the price could receive downward pressure if the cryptocurrencies have a massive correction.**

Digital securities (centralized, permissioned issuances) are not in *any way* related to cryptocurrencies (decentralized, permissionless issuances), beyond the fact that they utilize the same technology. Therefore, changes in the cryptocurrency market will have no impact whatsoever on equity-based digital securities.

## **What is the difference between regular paper/electronic securities and digital securities?**

Paper securities require a lot of space to store and a lot of time to find. Electronic securities reduced the storage and access inefficiencies of paper securities; however, they were not programmable, so their benefits ended there. Digital securities have all the same qualities of electronic securities, plus they come with a lot of additional benefits (see below).

## **What are the risks of digital securities compared to regular securities?**

There are no known additional risks with digital securities versus regular securities.

## **My lawyers and accountants are telling me there are additional risks.**

There are not; there are no known additional risks compared to regular securities. They are mistaking their lack of comprehension (and the fear that comes with that) with a valid concern. We'd suggest you help them find information to remedy that gap in understanding, or simply find new advisors that understand this emerging economy. The additional benefits are just too significant to ignore:



## What are the benefits of digital securities over regular securities?

- **Transparent and Immutable.** Digital securities create transparency and reliability. Changes cannot be made to the transaction data, providing direct and definitive ownership for investors.
- **Fast and Efficient.** Through smart contracts and automations, digital securities eliminate most intermediaries and facilitates 24/7/365 peer-to-peer trading with instant settlement.
- **Fractional Ownership.** Ownership of many digital assets will be divided into increasingly smaller parts. This enables access to a larger pool of investors, many who would not otherwise have access.
- **Freeze and Burn.** Issuers control all tokens. They can freeze the tokens if they feel there is any threat to proper custody, and can also burn and re-issue if they are lost.
- **Buy-back and Redemption.** Conditions for repurchasing tokens from shareholders and other types of shareholder redemptions can be programmed into the digital security.
- **Compliance Reporting.** Built-in global regulatory compliance coded into the digital security and protocol levels can produce reports on compliance for regulators.
- **Auditing.** Financial audits and other accounting can be done via the blockchain. Summaries can also be published to the chain.
- **Notifications.** Important company updates can be sent to token holders and recorded to the blockchain to preserve the communications in a public record.
- **Voting.** The issuer or governing entity can push requests to token holders to vote on important company matters.
- **Stock-Splits.** If/when the cost of a single share becomes too great, the issuer may split the shares programmatically, which would take effect immediately.
- **Dividends.** Investors can share in revenue and marketplace growth through preferred dividends, via automated payments on the blockchain.
- **Global Liquidity.** Fractionalizing tangible assets through tokenization will bring liquidity into markets that have had little to no access to it, creating a truly global investor network, driving up value of the securities.

**None** of these benefits are provided by regular securities.

For more information, see [From Seed Round to Digital Security Offering](#).

If you have questions, please email [connect@exg.ai](mailto:connect@exg.ai).