

Two offerings – one token: Simultaneous Rule 506(c) and Reg S offerings of security tokens

Apr 01, 2019

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Blockchain and Digital Assets
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While the ICO market weathers a frigid crypto winter and awaits further regulatory clarity, many issuers have conceded that their digital asset is a "security" and are proceeding under available exemptions from registration under U.S. securities laws.

Proper use of two popular exemptions (under Rule 506(c) and Regulation S) requires careful planning. When marketing their digitized securities, for example, companies need to align the format and reach of each promotion with the restrictions of each rule. Purchaser screening under Rule 506(c) is also more robust than that under Regulations S.

As most everyone considering a security token offering already knows, Rule 506(c) allows for "general solicitation" (meaning you can publicize the offering on Twitter, Telegram or tv) if the issuer takes "reasonable steps to verify" that **all** purchasers are accredited investors.

Importantly, Rule 506(c) does not limit this accreditation requirement to only U.S. purchasers. Yet some issuers mistakenly assume that the availability of Regulation S (which generally provides for an exemption from registration for a sale outside the U.S.) means that they do not need to verify the accredited status of non-U.S. purchasers.

Even though issuers can outsource this verification process to third parties, some non-U.S. purchasers less familiar with U.S. securities law concepts balk at having to deliver personal financial information required for accreditation.

With careful attention to detail, an issuer can conduct simultaneous Rule 506(c) and Regulation S compliant offerings and avoid subjecting foreign purchasers to verification. One tradeoff is that advertisements under Regulation S must be channeled away from U.S. persons. As simultaneous is here synonymous with separate, a

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company may find it more cost-effective to choose either Rule 506(c) or Regulation S rather than to comply with both rules at once.

For those wanting to have their cake and eat it too, certain requirements must be met, including:

- Blocking U.S. Investors: Websites should be designed to screen U.S. users from access to information about the Regulation S offering. Even though the terms of the two offerings can be virtually identical, users of U.S. IP addresses should be prevented from viewing any information disseminated to potential non-U.S. investors. Issuers often employ a landing page (which does not contain any of the material terms of the offering) directing non-U.S. persons to one-click through and U.S. users to another.
- Distinct Offering Documents: Regulation S requires that the offering documents contain specific legends that the instrument is being sold in reliance on Regulation S and may not be resold to U.S. investors. The subscription documents should also require the non-U.S. investor to make representations about his or her citizenship and location and agree to abide by Regulation S transfer restrictions.
- Preventing Flowback: Securities, whether digital or analog, sold pursuant to Regulation S may be traded immediately outside the United States but generally may not be resold to U.S. persons (i.e. "flowback") for at least one year. While issuers can geofence for IP addresses, the pseudo-anonymous nature of wallets makes it impossible to know the geographic location of a wallet holder. For this reason, best practice suggests that any digital assets sold outside the U.S. be locked for at least one year, guaranteeing no flowback. Relying solely on covenants in the offering documents that purchasers will not resell the tokens to U.S. investors is not enough to keep the issuer from blowing the Regulation S exemption by not taking reasonable precautions to prevent flowback.

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