

SECURITY TOKEN REGULATION IN ASIA

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Introduction

In 2016 and 2017, we witnessed the stellar success of ICOs and their steep drop in 2018. The ease of raising capital via unregulated token sales was initially their blessing but later became their curse. FOMO (fear of missing out) attracted many inexperienced investors, which bought tokens of projects, which neither had a compelling product nor an excellent team to execute. Moreover, even worse: after scrutinizing their wallets, investors learned the hard way that most of their ICO tokens don't give them any say in the future development of the products promised to them in the project whitepapers, much different to equity investments.

Since the end of last year, the investors' focus has changed towards security tokens. Security tokens represent securities, as a rule, i.e., financial instruments. Investing in security tokens gives investors more rights. However, consequently, token issuers, investors, intermediaries and marketplaces (exchanges) must consider the national securities regulations being applicable in the specific case.

Internationally, securities regulation differs, despite regional harmonizing efforts, e.g., in the [European Union](#) and the standard-setting work of the [International Organization of Securities Commissions \(IOSCO\)](#) and its members. For token issuers and other parties involved in the process, this means that it is not enough to follow national securities regulation. They need to consider also the securities laws of all other countries, where they want to offer their security tokens publicly, i.e., doing active marketing. Some regulatory authorities consider translated websites already being public offers in their jurisdiction. Other bodies put limits on the number of domestic investors or their individual or aggregated investment amount. Consequently, the issuer might need to file prospectuses with several regulatory authorities in different jurisdictions.

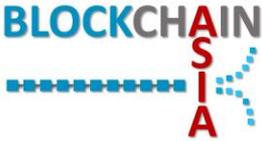
Finally, tokens have not already been recognized everywhere as a legal way to represent securities. This is work in progress, and some jurisdictions adopt quicker than others by changing their regulations where needed.

We want to analyze the situation in several Asian markets in this paper:

China (Mainland)

The People's Bank of China officially banned security token offering businesses on 08 December 2018, in addition to the [ICO ban issued on 04 September 2017](#).

Pan Gongsheng, Deputy Governor of the People's Bank of China, told an internet finance forum in Beijing that "illegal financing activities through STOs and ICOs were still rampant in the mainland despite a nationwide clean-up of the cryptocurrency market last year," according to a [report of the South China Morning Post](#).



“The STO business that has surfaced recently is still essentially an illegal financial activity in China,” he told the forum, according to state-owned China Central Television. “Virtual money has become an accomplice to all kinds of illegal and criminal activities.”

Status Quo Mainland China				
Token issues, e.g., ICO permitted in general	Clear definition of security tokens agreed	Policy discussions ongoing with the regulator	Regulation allows for tokenized securities	First STOs successfully conducted

Hong Kong

The [Securities and Futures Commission \(SFC\)](#) has issued a “[Statement on Security Token Offerings](#)” (STOs) on 28 March 2019. SFC states that “STOs typically refer to specific offerings which are structured to have features of traditional securities offerings and involve Security Tokens which are digital representations of ownership of assets (e.g., gold or real estate) or economic rights (e.g., a share of profits or revenue) utilizing blockchain technology. Security Tokens are normally offered to professional investors only. In Hong Kong, Security Tokens are likely to be securities under the Securities and Futures Ordinance (SFO) and so subject to the securities laws of Hong Kong.”

Consequently, marketing and distribution of Security Tokens (whether in Hong Kong or targeting Hong Kong investors) requires a license or registration for dealing in securities under the SFO. Intermediaries doing so have “to ensure compliance with all existing legal and regulatory requirements.”

Further, SFC expects intermediaries to observe the following “requirements:

- **Selling restrictions:**
 Where an intermediary markets or distributes Security Tokens, it must be licensed or registered for Type 1 regulated activity (dealing in securities) and the Security Tokens should only be offered to professional investors.
- **Due diligence:**
 Intermediaries distributing Security Tokens should conduct proper due diligence in order to develop an in-depth understanding of the STOs. This should include but is not limited to, the background and financial soundness of the management, development team and issuer as well as the existence of and rights attached to the assets which back the Security Tokens.
 Intermediaries should also scrutinize all materials relevant to the STOs including published information such as the whitepaper and any relevant marketing materials. Intermediaries should also ensure that all information given to their clients is accurate and not misleading.
- **Information for clients:**
 To help clients make informed investment decisions, intermediaries should provide the information in relation to STOs in a clear and easily comprehensible manner. Intermediaries should also provide prominent warning statements covering risks associated with virtual assets.”

Finally, SFC reminds intermediaries “to discuss with the SFC before engaging in any activities relating to STOs.”

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India

The [Reserve Bank of India \(RBI\)](#) gave already a quite cautious [statement on cryptocurrency trading and ICOs on 05 December 2017](#). About the same time, the [Securities and Exchange Board of India \(SEBI\)](#) SEBI organized tours to the UK, Japan, and Switzerland to study ICOs, as stated in their [annual report 2017/2018](#).

Unfortunately, there is no explicit statement on ICOs or even security tokens. That said, SEBI might consider any token as a security token if it satisfies the definition of “securities” under section 2(h) of [Securities Contract Regulation Act \(SCRA\)](#) of 1956:

- shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or another body corporate;
- derivative;
- units or any other instrument issued by any collective investment scheme to the investors in such schemes;
- security receipt as defined in section 2 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- units or any other such instrument issued to the investors under any mutual fund scheme;
- Government securities;
- such other instruments as may be declared by the Central Government to be securities; and
- rights or interest in securities.

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Japan

The [Japan Cryptocurrency Business Association \(JCBA\)](#) has published a report on 08 March 2019 with "[Recommendations for New ICO Regulations.](#)" The report, compiled for presentation to the [Japanese FSA](#), also covers security tokens and discusses necessary changes to the Financial Instruments and Exchange Act and the Fund Settlement Act.

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Malaysia

The [Securities Commission Malaysia \(SC\)](#) stated [on 14 January 2019](#) that they will "put in place guidelines to regulate offering and trading of digital assets." The move comes after the Malaysian Finance Minister Lim Guan Eng commented in public on the new Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order, being effective as of 15 January 2019. According to this new order, digital currencies and digital tokens & assets are considered to be securities, and the SC will regulate them.

The Minister said that "any person offering an ICO or operating a digital asset exchange without SC's approval may be punished, on conviction, with imprisonment not exceeding ten years and fine not exceeding RM10mil."

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Philippines

The [Securities and Exchange Commission Philippines \(SEC\)](#) has proposed [rules for ICOs on 02 August 2018](#) and [updated rules on 27 December 2018](#). It published them for public comment. Those draft rules require any token issuer to file a comprehensive initial assessment request with the SEC. "The SEC will review the initial assessment request to determine whether the token is a security."

The draft rules state that "start-ups that are conducting or will conduct an ICO involving security tokens, as found by the Commission during the initial assessment shall register as a corporation under the Securities Regulation Code (SRC)."

It also stipulates the exemptions from registration of security tokens, e.g., for token sales to fewer than 20 persons in the Philippines in any twelve months or qualified buyers like banks, investment houses, insurances, pension funds, investment companies or "other persons the Commission may rule by determining as qualified buyers."

Furthermore, the draft rules state that “a security token issuer must at all times comply with these rules, the provisions of the SRC, implementing rules and regulation and other laws implemented by the Commission.”

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Singapore

The [Monetary Authority of Singapore \(MAS\)](#) has published an update of “[A Guide to Digital Token Offerings](#)” on 30 November 2018. Already in the first sentence, MAS stresses again that “if a digital token constitutes a product regulated under the securities laws administered by MAS, the offer or issue of digital tokens must comply with the applicable securities laws.”, as MAS stated already on 01 August 2017.

In its guide, MAS provides a (non-exhaustive) list of capital market products “a digital token may constitute:

- a share, where it confers or represents an ownership interest in a corporation, represents a liability of the token holder in the corporation, and represents mutual covenants with other token holders in the corporation *inter se*;
- a debenture, where it constitutes or evidences the indebtedness of the issuer of the digital token in respect of any money that is or may be lent to the issuer by a token holder;
- a unit in a business trust, where it confers or represents an ownership interest in the trust property of a business trust;
- a securities-based derivatives contract, which includes any derivatives contract of which, the underlying thing is a share, debenture or unit in a business trust; or
- a unit, in a collective investment scheme (CIS), where it represents a right or interest in a CIS, or an option to acquire a right or interest in a CIS.”

MAS further clarifies that “offers of digital tokens which constitute securities, securities-based derivatives contracts or units in a CIS are subject to the same regulatory regime under Part XIII of the Securities and Futures Act (Cap. 289) (“SFA”), as offers of securities, or securities-based derivatives contracts or units in a CIS respectively made through traditional means. Offers must be made in or accompanied by a prospectus that is prepared under the SFA and registered with the MAS (“Prospectus Requirements”).”

The following exemptions from the Prospectus Requirements apply, “subject to certain conditions which include advertising restrictions:

- the offer is a small (personal) offer that does not exceed S\$5 million (or its equivalent in a foreign currency) within any 12 months, subject to certain conditions;
- the offer is a private placement offer made to no more than 50 persons within any 12 months, subject to certain conditions;
- the offer is made to institutional investors only; or
- the offer is made to accredited investors, subject to certain conditions.”

In its guide, MAS also details requirements for marketplaces and platforms, where security tokens are issued, offered or traded. Finally, MAS reminds intermediaries, e.g., financial advisors, that they need to be authorized to do so. This requirement also applies to overseas financial advisers, if they provide financial advice in Singapore related to security tokens.

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South Korea

The [Korean Financial Services Commission \(FSC\)](#) has reconfirmed in a [press release on 31 January 2019](#) the ICO ban issued, which was published originally on [29 September 2017](#): "All forms of ICO including securities issuance type are prohibited."

Preceding was an intensive debate in the Korean parliament about lifting the ICO ban. However, a survey conducted by FSC in autumn 2018 found out, that several Korean start-ups set up paper companies in Singapore to circumvent the ICO ban and raised money from Korean citizens in 2018. Some of those companies also missed disclosing relevant information for investors, according to the FSC.

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Taiwan

According to a [report in the Taipei Times](#), the [Financial Supervisory Commission \(FSC\)](#) is "drawing up national standards for initial coin offerings (ICOs) to make virtual tokens as easy to invest in as stocks and just as liquid," Chairman Wellington Koo stated on 22 October 2018. "The draft is to be completed by June 2019", he told a meeting of the Legislative Yuan's Finance Committee.

"The commission would regulate ICOs," Koo said but added that tokens exchanged for goods would not be covered by the standards.

"If the token in an ICO functioned similar to a security, the commission would define it as a securities token and subject it to the Securities and Exchange Act," [Securities and Futures Bureau](#) Deputy Director-General Tsai Li-ling said.

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Thailand

The Legislative National Assembly endorsed an [amendment to the Security and Exchange Act on 08 February 2019](#), which effectively enables tokenized securities by a minor modification.

Already in the [Emergency Decree on Digital Asset Businesses B.E. 2561 as of 10 May 2018](#), requirements have been set for the token issuance. The [Securities and Exchange Commission \(SEC\)](#) stated on 15 May 2018 that the new legislation "was enacted to regulate the offering of digital assets and businesses undertaking digital asset-related activities."

[SEC Secretary-General Rapee Sucharitakul said](#): "The underlying purpose of the Royal Decree on Digital Asset Businesses is to regulate and supervise offering of digital tokens and undertaking of digital asset businesses, including exchange, brokerage, and dealing. The legislation also aims to protect investors from risks of fraud and deception by dishonest persons, money laundering and exploitation of digital assets to facilitate illegal financial transactions, while ensuring regulatory clarity to facilitate legitimate uses of digital assets."

The SEC stated further that "the offering of newly issued digital tokens to the public must be conducted only by limited companies or public limited companies on the condition that such issuers have already obtained an approval and filed the registration statement and draft prospectus with the SEC, and such offering must be carried out through ICO Portal recognized by the SEC Board." Subsequently, the issuers have an ongoing duty to prepare and submit reports to the SEC Office about their financial condition, business operation or any other information which may affect the rights and interest of digital asset holders or investment decision-making.

Finally, the SEC has published [clear guidelines for offering digital tokens to the public](#) under the Digital Asset Businesses Act.

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Conclusion

While we haven't seen a security token offering in Asia yet according to [STOCheck](#), some countries have already created a sound regulatory framework for doing so. Developments in Hong Kong and Singapore, but also in the Philippines and Thailand are very encouraging. Only China and South Korea have extended their ICO bans to security tokens as well.

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