



DIGITAL SECURITIES OFFERING IN MALAYSIA (PART 1)

The following article is the first of our two-part series on the topic of Digital Securities Offerings in Malaysia.

Brief Overview of Digital Securities Offerings

A Digital Security Offering (“**DSO(s)**”) is an offering and sale of securities that are issued and exist on a blockchain, which makes them digital securities. DSOs are also commonly referred to as security token offerings (STOs) or token generating events, during which “security tokens” are issued to investors.[1] The tokens issued to the investors represent a share of an underlying asset. These can be shares of a company or any asset that is expected to turn into a profit, including a share in the ownership of a property, fine art, investment funds, etc.

DSO is similar to other securities offerings, but rather than receiving a stock certificate or note, investors receive digital representations of their investment, which may, at some time in the future, be exchangeable on one or more approved digital security exchanges. [2] According to Darren Marble, CEO of Issuance.com, “digital securities use blockchain technology to improve transparency, streamline capital formation, and reduce fraud.”[3]

The DSO model could also be likened to the more familiar Initial Coin Offering (“**ICO**”); however, DSOs gain their value from the net asset value of the asset backing the product and do not correlate to the price of Bitcoin like in ICOs.[4] The other main difference between ICO and DSO is that most ICOs are meant for raising funds in an unregulated environment and most ICOs actually position their offerings as utility tokens to circumvent regulations while STOs are launched with regulatory governance in mind and they are registered with required government bodies, meeting all the necessary legal requirements.[5]

Regulatory Framework in Malaysia

The law on digital currencies and digital tokens came into effect on 15 January 2019. With the Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019 (“**Order**”) coming into effect, digital currencies and digital tokens or digital assets are prescribed as securities and will be regulated by the Securities Commission (“**SC**”).[6]

Subsequently, the SC issued the revised Guidelines on Recognised Markets on 31 January 2019 to introduce provisions to facilitate the registration of operators of digital asset exchanges in Malaysia. An operator of a digital asset exchange is to be registered as a Recognised Market Operator (“**RMO**”) under section 34 of the Capital Markets and Services Act 2007 (“**CMSA**”) and the said Guidelines. A digital asset exchange operator (“**DAX Operator**”) is an RMO who operates an electronic platform which facilitates the trading of a digital asset (“**DAX Exchange**”).[7]

On 4 June 2019, SC had registered three (3) Recognized Market Operators (RMOs), namely Luno Malaysia Sdn Bhd, SINEGY Technologies (M) Sdn Bhd, Tokenize Technology (M) Sdn Bhd, to establish and operate DAX Exchange in Malaysia. SC also directed that apart from the three RMOs mentioned above, no other online platforms are permitted to establish and operate a DAX Exchange in Malaysia currently.[8]

With the emergence of DSOs and to regulate the issuance of digital tokens for fundraising, the SC released the Guidelines on Digital Assets on 15 January 2020 (“**Guidelines**”) which outlines the framework for raising funds via digital token offerings in the country and via media release on same date stated that the Guidelines will be brought into force in the second half of 2020. The Guidelines provide that all offerings of digital tokens in the country shall be undertaken through an Initial Exchange Offering (“**IEO**”) platform that has been duly registered with the SC and sets out the requirements for offerings of digital tokens to be carried out through an IEO that is registered with SC. [9] The key definitions and requirements will be further detailed below. An IEO operator is essentially an electronic platform operator which is registered under the Guidelines to operate an IEO platform.

(i) Definitions of Digital Assets, Digital Currency and Digital Token

Terms	Definition
Digital Assets	refers collectively to a digital currency and digital token
Digital Currency	a digital representation of value which is recorded on a distributed digital ledger whether cryptographically-secured or otherwise, that functions as a medium of exchange and is interchangeable with any money, including through the crediting or debiting of an account
Digital Token	A digital representation which is recorded on a distributed digital ledger whether cryptographically-secured or otherwise

(ii) When Will Digital Assets Amount to Securities?

Under the Order, ‘digital currency’ and ‘digital token’ are securities for the purposes of securities laws in Malaysia if the criteria set out in the Order are satisfied.

A **Digital Currency** is prescribed as securities for the purposes of securities laws if –

- a. It is traded in a place or facility where offers to sell, purchase, or exchange of, the digital currency are regularly made or accepted;
- b. A person expects a return in any form from the trading, conversion or redemption of the digital currency or the appreciation in value of that currency; and
- c. It is not issued or guaranteed by any government body or central banks as may be specified by the SC.

A **Digital Token** is prescribed as securities for the purposes of securities law if –

- a. The person receives the digital token in exchange for a consideration;
- b. The consideration or contribution from the person, and the income or returns, are pooled;
- c. The income or returns of the arrangement are generated from the acquisition, holding management or disposal of any property or assets or business activities;
- d. The person expects a return in any form from the trading, conversion or redemption of the digital token or the appreciation in the value of the digital token;
- e. The person does not have day-to-day control over the management of the property, assets or business of the arrangement; and
- f. The digital token is not issued or guaranteed by any government body or central banks as may be specified by the SC.

(iii) Requirements in Respect of IEO Platforms

The Guidelines set out the requirements to be met by an applicant and criteria considered by the SC for an application to be registered as an IEO operator. Unless otherwise specified by the SC, only locally incorporated companies may apply to the SC to be registered as an IEO operator. In respect of financial requirements, an IEO operator must have a minimum paid-up capital of RM5,000,000. In addition, a responsible person who is fit and proper shall be appointed to be the main contact person liaising with the SC and must perform any duty as may be directed by the SC. Specific requirements relating to the board of directors and management team of an IEO operator are also set out in the Guidelines. Where an IEO operator seeks to facilitate the trading of digital assets, it is required to be additionally registered as a DAX operator under the Guidelines on Recognized Market.

As mentioned above, an IEO operator operates the IEO platform. The Guidelines also specify the obligations of IEO operator. For example, in determining whether to approve a DSO, IEO operators must carry out due diligence and assessment on issuers by verifying the business of the issuer, assess the fit and properness of the issuer's board, and understand the features of the digital tokens before approving a digital token offering. Apart from the aforesaid obligations, other requirements include establishing a risk management framework and managing conflict of interest in the manner prescribed under the Guidelines. They must also maintain a trust account with licensed financial institutions, and keep a register of initial token holders. IEO operators remain accountable for all outsourced functions and must be in compliance with the outsourcing obligations stipulated in the Guidelines.

(iv) Requirements in Respect of Issuers and Digital Offering

The Guidelines require an issuer of digital tokens to be a locally-incorporated company with business operations in Malaysia and a minimum paid-up capital of RM500,000. Other requirements relating to an issuer's board of directors and senior management are also set out in the Guidelines.

Companies seeking to issue digital tokens are required to submit an application together with a disclosure document ("**Whitepaper**") to a registered IEO operator. The application should demonstrate that the underlying business or project of digital tokens provides an innovative solution or a meaningful value proposition for Malaysia. The Whitepaper must contain certain minimum information that would enable an investor to make an informed assessment of the digital token before subscribing to the digital tokens, including among others the objective of the digital token offering, key characteristic of digital tokens, the targeted amount to be raised and subsequent use of the proceeds thereafter, any rights, conditions or functions attached to digital tokens, etc as prescribed under the Guidelines.

In addition, the Guidelines specify on-going obligations that issuers have to comply with after their offering of digital tokens has been approved. For example, an issuer must provide a confirmation to the SC that the drawdowns have been utilised for the purposes stated in the Whitepaper and establish a mechanism which sets out the policies and procedures to manage issues of conflicts of interest and any related party transactions which may arise in the course of the digital token's project. Other obligations include informing the IEO operator in the event of material changes via an announcement on the IEO platform, reporting and audit requirements, and matters relating to marketing and promotion are also detailed in the Guidelines. Also, issuers must not be hosted concurrently on multiple IEO platforms or on an equity crowdfunding platform, and the maximum amount of funds that an issuer can raise within a 12-month period is limited to 20 times the amount of its shareholders' fund subject to a ceiling of RM100 million.

(v) Investment Limits

Different investment limits apply depending on the status of investors and are imposed on different types of investors. For retail investors, a cap of RM2,000 per issuer and a total investment limit of RM20,000 within a 12-month period will apply. Angel investors can invest in the offering of digital tokens up to RM500,000 within a 12-month period, while there is no restriction for sophisticated investors.

The Impact and Importance of the Guidelines

The release of the Guidelines will provide a safer environment for investors, issuers and stakeholders. According to the SC, DSOs can only be carried out on an IEO platform registered with the regulator. This is unlike initial coin offerings (ICOs) in other parts of the world, where the tokens are sold directly to investors.

An ICO is a crowdfunding exercise where a company creates a digital coin to raise money for its projects or operations. The coins may represent a stake in the company or project, or can be utilised to acquire its products and services. Despite emerging in 2013, ICOs only took off in 2017, when the software for these offerings was standardised in the market.

ICOs emerged at a time when the cryptocurrency space was largely unregulated. As a result, the space gained a bad reputation for various problems related to scams and fraud, on top of insufficient disclosures and inadequate investor protection. Most of the ICOs were unvetted, though some were vetted by the community, not regulators.

With the guidelines, investors will have peace of mind, knowing that they are putting their money into an asset issued on a regulated exchange and monitored by the local authority, says Kelvyn Chuah, co-founder of SINEGY Marketplace. "Over the past few years, a large number of ICOs have gone unvetted. Hopefully, investors will now be able to easily differentiate real investments from risky schemes and potentially fraudulent ones."^[10]

Note: Do keep a look out for the Part 2 of this series soon which is a Q&A between Ian Fong (Director of Marketing & PR, Propine Technologies Pte. Ltd.) and our Partner, Serina Abdul Samad.

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- 1 <https://dilendorf.com/blockchain/digital-security-offerings.html>
 - 2 <https://seriesone.com/digital-securities-offerings/#collapse-faq-496>
 - 3 <https://www.forbes.com/sites/jpreissler/2019/02/20/when-will-we-see-the-emergence-of-digital-securities/#527b9e9366e5>
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 - 9 <https://www.theedgemarkets.com/article/sc-prescribes-ieo-model-digital-token-offering>;
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