



MAS CLARIFIES STANCE ON DIGITAL TOKENS

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Legal Briefings

On 1 August 2017, the Monetary Authority of Singapore (**MAS**) [clarified](#) through a media release that an offer or issue of digital tokens would be regulated if these tokens constitute products which are regulated under the Securities and Futures Act (**SFA**). In doing so, the MAS sent a strong signal that it would focus on the substance of the transaction, even if it is presented within the "cryptocurrency" wrapper.

MAS' clarification comes in the wake of an increase in the number of initial coin or token offerings (**ICOs**) in Singapore. In June 2017, it was [reported](#) that blockchain startup TenX had raised close to US\$80 million from a token sale. A Singapore based startup, Cofound.it, also [launched](#) the sale of its own digital currency in May 2017 to fund building of its blockchain-based platform to connect start-ups with investors and experts for funding and advice. Further ICOs are [reported](#) to be planned later this year.

This article provides an introduction into ICOs and touches upon some of the market developments and regulatory issues surrounding ICOs and digital tokens.

WHAT ARE DIGITAL TOKENS AND ICOS?

A digital token is a cryptographically-secured representation of a token-holder's rights to receive a benefit or perform specified functions. One particular type of digital token is virtual currency like Bitcoin and Ether. Digital tokens are widely considered to be secure (as far as protection of the underlying value is concerned), liquid and anonymous in nature.

While a digital token may also be a cryptocurrency, a digital token's potential applications are wider in nature. Digital tokens may be offered through ICOs, which are fundraisings pursuant to which contributors are issued digital tokens in relation to underlying interests (which can be, for instance, a share of an investment pool or an asset), or other returns.

ICOs and other investment schemes involving digital tokens may be structured in many ways with different business propositions. For example, they may seek to develop a new digital platform. Others may offer an opportunity to invest in a property, business, and assets, or with a promise of certain benefits or monetary returns.

Typically, digital tokens may be purchased using other cryptocurrencies or the more traditional "fiat currencies" (such as the USD or SGD). Digital tokens are also likely to be tradable on the secondary market (subject to initial lock-in periods, which are not currently a regular feature of ICOs), which provides attractive liquidity options for contributors.

WHY ARE DIGITAL TOKENS IN FOCUS?

Digital tokens have recently attracted regulatory attention worldwide in light of fundraisings through ICOs. An ICO presents a means for an issuer to raise funds by selling its digital tokens in exchange for other cryptocurrencies (which have current and liquid value in the market, such as Bitcoin) or fiat currencies. Through such fundraisings, digital token issuers are able to engage with contributors directly (without using intermediaries like venture capital firms and banks).

While ICOs provide a means for issuers to connect directly with contributors, the traditional intermediaries (e.g. venture capital firms) are also exploring this space. For instance, a San Francisco-based venture capital firm which invests in blockchain-related technology (Blockchain Capital) [reportedly](#) closed its ICO earlier this year within six hours, after reaching its US\$10 million target. According to [reports](#), the ICO related to non-voting interests in one of Blockchain Capital's funds.

In Asia, Hong Kong-based technology startup Block.one [announced](#) on 2 July 2017 that it had raised about US\$185 million for its Ethereum-based tokens. At the time of the funding launch, Block.one did not release a working prototype of its development platform which is designed to make production of high performance decentralised applications fast and scalable. Block.one released a [white paper](#) on its software which was provided for information purposes only whereby the conclusions and representations made in the white paper were not guaranteed.

Such fundraising for venture capital funds through ICOs could have a transformative effect on the market – providing contributors (i.e. traditional "limited partners") with investment opportunities with relatively small investment packet sizes, eliminating the need to wait for five to ten years before an exit, and providing (relatively) attractive liquidity options on the secondary market.

REGULATORY IMPLICATIONS

Potential risks

The Singapore regulators have been concerned about the potential risks of digital token and virtual currency-related investment schemes.

Most recently on 10 August 2017, the MAS and the Commercial Affairs Department (**CAD**) [issued](#) a Consumer Advisory on Investment Schemes involving Digital Tokens (including virtual currencies) advising the public to exercise due diligence to understand the risks associated with ICOs and investment schemes involving digital tokens. The MAS and CAD noted that there was a heightened risk of fraud for foreign and online operators, as it would be difficult to verify their authenticity or trace their operators. There would also be risks relating to insufficient secondary market liquidity, a lack of proven track record of the seller, and the lack of transparency surrounding the investment.

In addition, ICOs are often seen as vulnerable to money laundering / terrorist financing (**ML/TF**) risks predominantly due to the anonymous nature of transactions involving digital tokens.

It has been [reported](#) that more than 100 Singaporean consumers have filed police reports over investment schemes involving digital tokens or currencies.

Classification of digital tokens

Previously, the MAS had [announced](#) on 13 March 2014 that while it did not regulate the functioning of virtual currency transactions, it would regulate virtual currency intermediaries in Singapore to address ML/TF risks.

In the 1 August 2017 media release, the MAS observed that the function of digital tokens had evolved beyond just being a virtual currency. The MAS clarified that if the use of a digital token relates to ownership of, or a security interest over, an issuer's asset or property, it may be considered to be an offer of shares or units in a collective investment scheme under the SFA.

Similarly, if a digital token represents a debt owed by the issuer to the contributor, it may be considered to be a debenture under the SFA. Where digital tokens fall within the definition of securities in the SFA, issuers of such tokens would be required to lodge and register a prospectus with MAS prior to the offer of such tokens, unless exempted. Issuers or intermediaries of such tokens would also be subject to licensing requirements under the SFA and Financial Advisers Act, unless exemptions apply. In addition, platforms facilitating secondary trading of such tokens would also have to be approved or recognised by MAS as an approved exchange or recognised market operator respectively under the SFA.

This position follows a similar ruling by the US Securities and Exchange Commission ("**SEC**") [made](#) on 25 July 2017 that ICOs are subject to the requirements of the federal securities laws. The SEC noted in its report that tokens offered and sold by a virtual organisation known as "The DAO" were securities subject to federal securities law. The SEC also confirmed that issuers of distributed ledger or blockchain technology-based securities must register offers and sales of such securities unless a valid exemption applies. Those participating in unregistered offerings may be liable for violations of securities laws, and securities exchanges providing for trading in these securities must register unless they are exempt.

However, there are likely to be infrastructure challenges for startups, companies and exchanges operating in the virtual currency sector to making ICOs compliant with securities laws of Singapore and the US. The primary exchanges on which tokens are traded have traditionally not been registered, and the bitcoin infrastructure does not currently handle digital tokens as securities.

CONCLUSION

The decision by the MAS to follow the US to clarify the position towards digital tokens and ICOs and regulate them as securities is a step towards harmonising international oversight of crypto currencies.

Various regulatory bodies have also been considering appropriate regulation – for instance, the US Commodities Futures Trading Commission recently in July 2017 [granted](#) blockchain startup LedgerX its formal registration as a swap execution facility to trade digital currency derivatives. Japan also promulgated a [Virtual Currency Act](#) in April 2017 which recognises certain well-established cryptocurrencies, namely Bitcoin and Ether, as legal means of payments, and imposes regulations on cryptocurrency operators.

Companies considering ICO fundraisings in Singapore which may involve the use of digital tokens should carefully consider the impact of the regulatory framework. If a digital token represents a security which may be within the scope of the SFA, the issuer should comply with applicable requirements under law. Issuers would also be well advised to continue to track developments in the regulatory space in general, such as those relating to ML/TF compliance.

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KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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