



Navigating Security Token Offerings in Singapore

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From the heady times of 2017 when the price of Bitcoin was almost \$20,000 to the current under \$5,000 value and uncertain state of the market, the crypto space has indeed been evolving at a rapid pace. Many founders had launched initial coin offerings (“ICOs”) and managed to raise large amounts of capital. Hordes of investors participated in ICOs hoping to reap a quick reward – and many did. However, many of the cryptocurrencies that were launched have not held their value and are now worth very little indeed.

With the benefit of hindsight, it seems safe to say that much of the enthusiasm over cryptocurrencies should have been tempered with a healthy scepticism. Satoshi Nakamoto designed the Bitcoin ecosystem to be trustless; meaning that, by eliminating the double spending problem, it would not be necessary for parties in a transaction to trust each other. However, the intense interest in ICOs did, in a sense, rely on trust. People and institutions who participated in ICOs and bought cryptocurrencies trusted the founders to deliver on their promises and develop platforms and ecosystems in which the cryptocurrencies would be useful and valuable. To a large extent, this has not materialised – yet.

Where does that leave the cryptoverse? Perhaps it is time to return to a system that relies less on trust. In an excellent example of the strength of a decentralised ecosystem, many cryptocurrency enthusiasts are now looking into tokenised securities. This phenomenon was not

initiated by any centralised authority – it occurred naturally, prompted by the need to address a pressing issue.

While ICOs relied heavily on participants trusting the emitting entities, securities rely rather less on trust. This is the nature of a security, it is secured by a bundle of rights that the buyer can deploy to enforce what they should receive. Whether it is a right to redeem a bond or vote at general meetings of a company, the holder of a security token has arguably greater rights than one holding a non-security token.

In keeping with Singapore's reputation as one of the global crypto havens, the Monetary Authority of Singapore ("MAS") has updated its *Guide to Digital Token Offerings* to provide further clarity on "security tokens", or tokens that are categorized as securities under Singapore law.

Shares

Under the regime set out in the Securities & Futures Act (Chapter 289) (the "SFA"), any offering of shares must comply with the Prospectus Requirements found in the SFA.

An offering of tokenised shares would be most suitable for a company with an existing platform and ecosystem. The offering would be similar to "going public" – allowing a company with strong fundamentals or valuable intellectual property to raise funds for future development.

Stocks that are already publicly listed may also be tokenised. For example, DX.Exchange has recently announced plans to tokenise shares in Apple, Facebook and Tesla.

Debentures

A debenture is defined in Singapore law as an instrument that creates or acknowledges a debt. A bond is a typical debenture that many people would have had experience with. However, whether a debt is or isn't a debenture depends very much on usage and custom. For this reason, it is extremely important to consult professional advisors who can determine whether the debt is a debenture and, hence, a security. Marketing an instrument that is not a security as a security could amount to misrepresentation.

A tokenised debenture, like a bond, could have a maturity date upon which the debenture would be redeemed with interest. Debentures, like shares, are a fund-raising method that would lend themselves well to companies with good fundamentals. For certain companies, issuing a tokenised debenture could be an excellent alternative to selling equity.

Stablecoins or tokens which have fixed value in fiat currency could also be debentures under the SFA. By way of an illustration, the MAS *Guide to Digital Token Offerings* describes a token that is to be bought and redeemed at the same value of fiat currency.

Collective Investment Schemes

A well known form of Collective Investment Scheme ("CIS") is the REIT or Real Estate Investment Trust. However, there can be many other kinds of CIS besides REITs. The *Guide to Digital Token Offerings* issued by the MAS provides another example of a CIS: pooling funds to invest in Fintech

start-up companies and mining or real estate with profits from the portfolio of investments to be distributed to holders of tokens.

Some of the defining characteristics of a CIS include:

- The participants do not have day-to-day control over the management of the property;
- The property is managed by a manager;
- The contributions of participants and profits are pooled;

A token that represents a fractional ownership in real estate or precious metals would very likely be a CIS. Issuing a tokenised CIS would involve selling tokens to create a pool of contributions which would then be used to invest in assets. Profits realised from the management of the assets could then be distributed to token holders.

Prospectus Requirements

Every offer of a security must be accompanied by a prospectus. In addition, the prospectus must include a products highlight sheet for certain complex instruments. A prospectus would be required to include all of the following information:

- Rights and liabilities attaching to the securities;
- The assets and liabilities, profits and losses, financial position and performance, and prospects of the issuer;
- The assets and liabilities, profits and losses, financial position and performance, and prospects of the underlying entity.

Exemptions

While complying with the prospectus requirements does require significant time, the SFA does provide exemptions for securities to be offered in certain situations:

- Small (personal) offers;
- Private placements;
- Offers to institutional investors; and
- Offers to accredited investors.

It is important to note that there are restrictions to the application of the above exemptions and issuers of tokenised securities should consult qualified professionals to ensure they do not fall afoul of the SFA. In addition, the above are defined terms under law, and legal advice should be sought to determine their meanings.

The STO roadmap in Singapore

Analysis of the nature of the token -is again the essential first step in order to determine whether the token is structured as a security. It is also important to bear in mind that securities law and regulation varies from country to country. Thus, a token may constitute a security under the Howey Test in the US, however, the same token may not be deemed a security under Singapore law. A token that is not a security would not be able to carry out an STO.

Deciding on the right vehicle or entity is a crucial step. Issuing a tokenised debenture could be carried out by a private company limited by shares but other kinds of securities would probably be issued by different types of entities. By its nature, a company issuing tokenised shares would almost certainly be a public company.

Finding an underwriter – to issue a security the established practise is to work with a financial institution that would act as the underwriter.

Preparing the prospectus – this document must be drafted very carefully to inform potential investors of the company’s business model and to disclose all the risks of investing.

Under Part XII of the SFA, the prospectus must set out all the information that investors and their professional advisers would reasonably require to make an informed assessment on the following:

- the rights and liabilities attaching to the securities or securities-based derivatives contracts
- in the case of an offer of securities or securities-based derivatives contracts other than units or derivatives of units in a business trust, the assets and liabilities, profits and losses, financial position and performance, and prospects of the issuer
- if the underlying entity is controlled by —
 - (i) the person making the offer;
 - (ii) one or more of the related parties of the person making the offer; or
 - (iii) the person making the offer and one or more of his related parties,the assets and liabilities, profits and losses, financial position and performance, and prospects of that entity
- in the case of an offer of units of shares or debentures, where —
 - (i) the person making the offer is or will be required to issue or deliver the relevant units, or meet financial or contractual obligations to the holders of those units; or
 - (ii) an entity which is controlled by one of the following is or will be required to issue or deliver the relevant units, or meet financial or contractual obligations to the holders of those units:
 - (A) the person making the offer;
 - (B) one or more of the related parties of the person making the offer;
 - (C) the person making the offer and one or more of his related parties,the capacity of that person or entity to issue or deliver the relevant securities, or the ability of that person or entity to meet those financial or contractual obligations
- in the case of an offer of securities or securities-based derivatives contracts being units or derivatives of units in a business trust, where —
 - (i) the person making the offer is the trustee-manager of the business trust; or
 - (ii) the trustee-manager of the business trust is controlled by —
 - (A) the person making the offer;

- (B) one or more of the related parties of the person making the offer; or
- (C) the person making the offer and one or more of his related parties,

the assets and liabilities, profits and losses, financial position and performance of the business trust and of the trustee-manager, and the prospects of the business trust

- in the case of an offer of securities or securities-based derivatives contracts being derivatives of units in a business trust issued by an entity (A) other than the trustee-manager of the business trust, where —
 - (i) the person making the offer is A; or
 - (ii) A is controlled by —
 - (A) the person making the offer;
 - (B) one or more of the related parties of the person making the offer; or
 - (C) the person making the offer and one or more of his related parties,

the assets and liabilities, profits and losses, financial position and performance, and prospects of A

- in the case of an offer of securities or securities-based derivatives contracts being derivatives of units in the business trust, where —
 - (i) the person making the offer is or will be required to issue or deliver the relevant units or derivatives of units, or meet financial or contractual obligations to the holders of those derivatives of units; or
 - (ii) an entity which is controlled by one of the following is or will be required to issue or deliver the relevant units or derivatives of units, or meet financial or contractual obligations to the holders of those derivatives of units:
 - (A) the person making the offer;
 - (B) one or more of the related parties of the person making the offer;
 - (C) the person making the offer and one or more of his related parties,

the capacity of that person or entity to issue or deliver the relevant units or derivatives of units in that business trust, or the ability of that person or entity to meet those financial or contractual obligations.

Profile Statement – this document would be filed with the prospectus and must contain:

- Identification of the person making the offer
- Where the person making the offer is not the issuer, identification of the issuer and, where applicable, the underlying entity
- In the case of an offer of securities or securities-based derivatives contracts being units or derivatives of units in a business trust, identification of the business trust, the trustee-manager of the business trust and the issuer
- Identification of the persons signing the profile statement
- The nature of the securities or securities-based derivatives contracts
- The nature of the risks involved in investing in the securities or securities-based derivatives contracts

- details of all amounts payable in respect of the securities or securities-based derivatives contracts (including any amount by way of fee, commission or charge)
- A statement that copies of the prospectus are available for collection at the times and places specified in the profile statement
- A statement that the persons referred to in section 240(4A) who have signed the profile statement are satisfied that the profile statement contains a fair summary of the key information in the prospectus

Product Highlights Sheet (“PHS”) – this must be given to investors when the offer is made and, if the offer is made online, the PHS should likewise be available online together with the offer. The PHS would be prepared in accordance with the MAS’ Guidelines On The Product Highlights Sheet For Offers Of Debt Securities, Hybrid Instruments And Equity Securities and would include the following information:

- Names of the issuer and guarantor
- Place(s) of incorporation
- Issue price and denomination
- Total amount to be raised in the offer
- Description of the Bonds, including maturity date, tenure, coupon rate and frequency of coupon payments
- Listing status of Issuer and the Bonds
- Issue Manager(s) / Arranger(s)
- Underwriter(s)
- Directors and Key Executives (for shares)
- Controlling shareholders/unitholders and sponsors (for shares)
- Historical financial performance and current financial position (for shares)
- Business strategies and future plans (for shares)
- Key trends, uncertainties, demands, commitments or events which are reasonably likely to have a material effect (for shares)
- Fees and charges payable to the trustee manager/responsible person (for business trusts and REITs)
- Key risks which had materially affected or could materially affect us and your investment (for shares)
- Rights attached to the securities (for shares)
- Whether dividends will be paid (for shares)
- Contact information (for shares)
- Credit rating of Issuer/ Guarantor (if applicable)/ the Bonds (if any) and Credit Rating Agencies
- Trustee / Registrar
- Investment suitability
- Background Information on the Issuer
- Key Financial Information
- Trends, Uncertainties, Demands, Commitments or Events Reasonably Likely to have a Material Effect

- Use of Proceeds
- Key risks
- Business-Related Risks
- Legal, Regulatory and Enforcement Risks
- Market and Credit Risks
- Liquidity Risks
- Other Pertinent Risks

Filing the registration document – the prospectus and profile statement must be filed with MAS and registered before the security can be offered.

Benefits and Risks of Tokenised Securities

Some of the benefits of tokenised securities are:

- Low barrier to entry
- Greater flexibility
- Access to global investors
- Compliance integrated with the blockchain
- Fractional ownership
- Trading at all hours
- Possibility of differentiating dividends based on length of time token is held

Some of the risks associated with tokenised securities are:

- The STO market is not mature yet
- Compliance can be more complicated
- Lengthy documentation is needed for the prospectus
- Longer timeframe
- Disclosure requirements are strict

While the crypto space is going through some fear, uncertainty and doubt, there is definitely cause for optimism as experts opine that the “fear selling is over” and “bottoming out has occurred” and the “genie cannot be put back in the bottle”, and it appears the prices of Bitcoin and Ethereum are enjoying a recent modest surge. Moreover, tokenisation seems set to revolutionise the securities market.

Link to news of plans to tokenise shares:

<https://www.bloomberg.com/news/articles/2019-01-03/tesla-stock-on-a-blockchain-offers-hint-of-where-crypto-s-headed>

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