

# DIGITAL ASSETS SERIES: CHAPTER 1

LEGAL UPDATE  
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## **Digital Assets: An Emerging Avenue for Investment and Fundraising**

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Interest in the use of blockchain and in the investment of blockchain-based digital assets has rapidly escalated in recent years, precipitated by the rise of cryptocurrencies (such as Bitcoin and Ethereum) to become one of the most celebrated class of digital assets around the world. Malaysia is no stranger to this phenomenon, as the usage and investment in cryptocurrencies have become popular since Bitcoin's first bull run in December 2017.

In early April 2021, the total market capitalisation for cryptocurrencies in the world had topped USD2 trillion for the first time.<sup>1</sup> Based on the reports provided by digital asset exchange ("**DAX**") operators to Bank Negara Malaysia ("**BNM**"), Malaysia saw an estimated 450,000 active DAX accounts actively trading in digital assets in 2020. In the same year, transaction values for digital assets trading were approximately RM105 million for the month of August.

Recognising the increasing demand for cryptocurrencies and its untapped potential, most countries have promulgated certain forms of regulations to facilitate and regulate the transactions of these digital assets. Similarly, the Securities Commission Malaysia ("**SC**") has taken a phased approach in developing the regulatory framework for digital assets, which will be considered in detail in this and our ensuing Articles.

As a part of our Digital Assets Series, we will be sharing a series of discussions on the legislative and regulatory framework developments relating to the digital asset space in Malaysia, and how it may emerge as an alternative major fundraising or investment avenue for businesses in Malaysia, in chapters as follows:

- Chapter 1 : Introduction to digital assets and its regulatory framework in Malaysia*
- Chapter 2 : Initial exchange offering ("**IEO**") and the regulatory framework for IEO operators in Malaysia*
- Chapter 3 : Digital asset custodian ("**DAC**") and the regulatory framework for DACs in Malaysia*
- Chapter 4 : The regulatory framework for persons seeking to raise funds via IEO in Malaysia*
- Chapter 5 : A general comparison between IEO and initial public offering ("**IPO**") in Malaysia*
- Chapter 6 : A general comparison between IEO and fundraising options in other recognised markets in Malaysia, namely equity crowdfunding ("**ECF**") and peer-to-peer financing ("**P2P**")*
- Chapter 7 : Digital tokens: use case studies*

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<sup>1</sup> <https://www.cnn.com/2021/04/06/cryptocurrency-market-cap-tops-2-trillion-for-the-first-time.html>

## Chapter 1: Introduction to Digital Assets and its Regulatory Framework in Malaysia

In this Chapter 1 of our Digital Assets Series, we offer a brief introduction on digital assets and its regulatory framework in Malaysia.

### 1. Introduction

- 1.1 Although the mechanics of blockchain may seem complex, the basic idea is that a blockchain is essentially a digital ledger of transactions that is duplicated and distributed across the entire network of computer systems on the blockchain. The distributed ledger is maintained and updated by independent nodes within a network and is secured by cryptography, creating an ecosystem where the network participants can confirm and create ledger entries without the need for a centralised party or intermediary. The ledger entries are then recorded in “blocks” and the blocks are “chained” together in sequence providing an auditable and tamper-proof history.
- 1.2 The advancement in blockchain technology has led to the development of “smart contracts”. A “smart contract” can digitally facilitate, verify or enforce the negotiation or execution of a contract automatically upon the triggering of a specified event as embedded into the blockchain of the digital asset. Hence, with properly prepared and incorporated smart contracts, digital assets are able to execute credible transactions without having to rely on third parties.
- 1.3 Given that digital assets have become increasingly programmable, they are now customisable and can perform a wide array of functions, therefore broadening its applicability. Further, digital assets have evolved over time to encompass different types and classes that have their individual specific uses and functions.
- 1.4 Without limiting to the legislative framework of Malaysia, a digital asset may generally be categorised as either a “digital currency” or a “digital token” depending on its usage and can be broadly understood as follows:

Digital Currency	Digital Token
<p>Digital currency:</p> <ul style="list-style-type: none"> <li>➤ can be used as a means for payment purposes (subject to acceptance of the digital currency);</li> <li>➤ are traded on digital asset exchange platforms; and</li> <li>➤ a person who trades digital currency expects to benefit from a return or</li> </ul>	<p>Digital token:</p> <ul style="list-style-type: none"> <li>➤ can be used depending on how the digital token is customised;</li> <li>➤ can be used, among others, as a means: <ul style="list-style-type: none"> <li>• to exchange a specific type of goods or services;</li> </ul> </li> </ul>

Digital Currency	Digital Token
<p>appreciation in the value of the digital currency traded.</p> <p>Some examples of digital currencies are Bitcoin and Ethereum.</p>	<ul style="list-style-type: none"> <li>• to confer assets and the obligations and rights attached to the assets;</li> <li>• to confer or exercise certain rights such as voting rights; or</li> <li>• to raise funds.</li> </ul> <p>➤ If the digital token is used as a means to raise funds:</p> <ul style="list-style-type: none"> <li>• the issuer will offer the digital tokens, directly or through an initial exchange offering platform, to investors who shall pay monies or digital currencies in exchange for the digital tokens received;</li> <li>• the monies of the investors are pooled and utilised by the issuer according to its white paper;</li> <li>• an investor who purchases the digital tokens expects a return or appreciation in value from their investment; and</li> <li>• the returns to investors may be derived from either the buying or selling of assets of the issuer or from any business activities carried out by the issuer which is set out in the white paper.</li> </ul> <p>Some examples of digital tokens are utility tokens, asset tokens and governance tokens.</p>

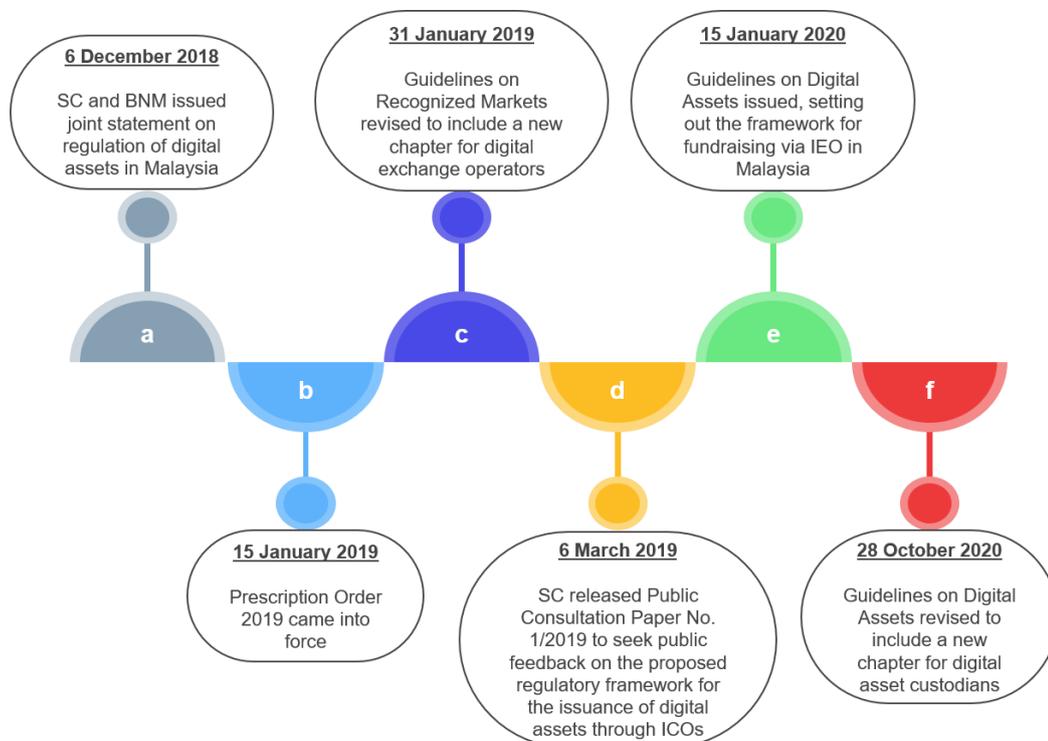
## 2. Historical developments of the regulatory framework for digital assets in Malaysia

2.1 There was a general perception that investors who invested their monies into digital assets were vulnerable to fraud and manipulation, particularly when investment in and trading of digital assets were largely unregulated. This was evident during the boom of initial coin offerings (“**ICO(s)**”) in 2017 where approximately 80% of the ICOs in that year were

identified as scams to which investors had fallen prey.<sup>2</sup> Such were the risks given that the issuers were not regulated and were offering digital tokens directly to the investors. Likewise, investors were also susceptible to fraud in the trading of digital currencies as certain operators of the trading platforms have been found to have swindled and laundered the monies of investors.<sup>3</sup>

2.2 Pursuant to the growing interest in digital assets among businesses and investors on a domestic and global scale, the SC had in recent years implemented steps to regulate digital assets to manage the emerging risks and safeguard the interests of investors.

2.3 We set out below a brief timeline of the regulatory developments in respect of digital assets in Malaysia thus far:



(a) On 6 December 2018, the SC and BNM issued a joint statement to provide clarity on the regulatory approach for the offering and trading of digital assets in Malaysia ("**Joint Statement**"). The Joint Statement provided that the SC will regulate issuances of digital assets via ICOs and the trading of digital assets at digital asset exchanges in Malaysia. In addition, ICO issuers and digital asset exchanges which are involved in the issuance or dealing of digital assets with a payment function will need to comply with relevant BNM laws and regulations and are subject to the SC's Guidelines on Prevention of Money Laundering and Terrorism Financing. BNM

<sup>2</sup> <https://www.finance-monthly.com/2018/10/the-10-biggest-ico-scams-swindled-687-4-million/>

<sup>3</sup> <https://www.justice.gov/opa/pr/serbian-founder-digital-asset-companies-indicted-international-cryptocurrency-scheme>

had also reiterated in the Joint Statement that digital assets are not legal tender in Malaysia.

- (b) On 15 January 2019, the Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019 ("**Prescription Order 2019**") came into force. The Prescription Order 2019 provided, among others, the definition for "digital currency" and "digital token" and the requirements for them to be prescribed as securities for the purposes of securities laws in Malaysia. Further details on the Prescription Order 2019 are set out in Paragraph 3.3 of this Article.
- (c) On 31 January 2019, the Guidelines on Recognized Markets ("**RM Guidelines**") was amended to include a new chapter (Chapter 15: Digital Asset Exchange) which sets out the regulatory framework for DAX operators who regulate and facilitate the trading of digital assets. To date, there are only three (3) registered DAX operators in Malaysia, namely Luno Malaysia Sdn Bhd, Sinegy Technologies (M) Sdn Bhd and Tokenize Technology (M) Sdn Bhd.<sup>4</sup>
- (d) On 6 March 2019, the SC released a Public Consultation Paper No. 1/2019 titled "*Proposed Regulatory Framework for the Issuance of Digital Assets through Initial Coin Offerings ("ICOs")*" ("**Public Consultation Paper**"). In the Public Consultation Paper, the SC sought public feedback on the proposed regulatory framework for ICOs in Malaysia, recognising the need to mitigate the risks posed by ICOs for purposes of investor protection and promoting confidence in the ICO market.
- (e) Following the responses received on the Public Consultation Paper, the SC had on 15 January 2020 issued the [Guidelines on Digital Assets](#) ("**DA Guidelines**"). The DA Guidelines introduce a framework for IEOs which applies to any issuer seeking to raise funds through digital token offering and any person intending to operate an IEO platform ("**IEO operator**").
- (f) On 28 October 2020, the DA Guidelines were revised to include a new chapter (Part D: Requirement for Digital Asset Custodian) to regulate a DAC, being any person intending to provide the services of safekeeping, storing, holding or maintaining custody of digital assets for the account of another person or entity.

2.4 Applications for registration to become an IEO operator had closed on 15 February 2021. As of the date of this Article, it would appear that such applications are still being processed by the SC. On the other hand, the SC has not imposed a deadline for applications to register to become a DAC at this juncture.

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<sup>4</sup> <https://www.sc.com.my/development/digital/digital-initiatives>

### 3. The regulatory position of digital assets in Malaysia

- 3.1 In Malaysia, the SC has defined digital assets as “a digital currency or digital token, as the case may be” in the RM Guidelines and the DA Guidelines.
- 3.2 The definitions of “digital currency” and “digital token” are provided in Section 2 of the Prescription Order 2019 as follows:

Digital Currency	Digital Token
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.	A digital representation which is recorded on a distributed digital ledger whether cryptographically-secured or otherwise.

Therefore, any digital assets which are not recorded on a distributed digital ledger are not deemed “digital assets” within the context of Malaysia’s regulation on digital assets.

- 3.3 Pursuant to the Prescription Order 2019:
- (a) Section 3 of the Prescription Order 2019 stipulates the requirements digital currencies and digital tokens have to satisfy to be prescribed as securities for the purposes of securities laws in Malaysia. The requirements are as follows:

Digital Currency	Digital Token
<p>A digital currency which:</p> <p>(a) is traded in a place or on a facility where offers to sell, purchase, or exchange of, the digital currency are regularly made or accepted;</p> <p>(b) a person expects a return in any form from the trading, conversion or redemption of the digital currency or the appreciation in the value of the digital; and</p> <p>(c) is not issued or guaranteed by any government body or central banks as may be specified by the Commission,</p>	<p>A digital token which represents a right or interest of a person in any arrangement made for the purpose of, or having the effect of, providing facilities for the person, where:</p> <p>(a) the person receives the digital token in exchange for a consideration;</p> <p>(b) the consideration or contribution from the person, and the income or returns, are pooled;</p> <p>(c) the income or returns of the arrangement are generated from the acquisition, holding,</p>

Digital Currency	Digital Token
is prescribed as securities for the purposes of the securities laws.	<p>management or disposal of any property or assets or business activities;</p> <p>(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;</p> <p>(e) the person does not have day-to-day control over the management of the property, assets or business of the arrangement; and</p> <p>(f) the digital token is not issued or guaranteed by any government body or central banks as may be specified by the Commission,</p> <p>is prescribed as securities for the purposes of the securities laws.</p>

For the avoidance of doubt, digital tokens which are not labelled as security tokens by the issuer may still be regarded as securities for the purposes of securities laws in Malaysia so long as they fulfil the criteria stated under the Prescription Order 2019.

- (b) Section 4 of the Prescription Order 2019 provides that digital currencies and digital tokens which are prescribed as securities shall be governed under the provisions of securities laws save and except for Division 3 of Part VI of the Capital Markets and Services Act 2007 ("**CMSA**") which relates to the prospectus requirement.
- (c) Section 5 of the Prescription Order 2019 provides that digital currencies and digital tokens which are prescribed as securities are not shares in or debentures of, a body corporate or an unincorporated body or units in a unit trust scheme or prescribed investments scheme if they are offered or traded on or through a recognized market.

3.4 The DA Guidelines shall be read together with other relevant laws and guidelines including payment services and foreign exchange administration laws administered by BNM, and are in addition to and not in derogation of any requirements provided for under securities laws

or any other guidelines issued by the SC. Pursuant to the foregoing, where an issuer issues a digital token which has the features of an existing type of securities such as unit trust funds, bonds, warrants or options, the issuer must also comply with the existing requirements for such issuance as set out in the relevant SC's guidelines in addition to meeting the requirements under the DA Guidelines.

- 3.5 As stated in the Joint Statement and as encapsulated under Paragraph 1.01 of the DA Guidelines, digital currencies and digital tokens are not recognised as a legal tender nor as a form of payment instrument that is regulated by BNM. In the same vein, the DA Guidelines stipulate that where a digital token serves as a payment instrument, such digital token may only be used in exchange for the issuer's goods and services as disclosed in its white paper.
- 3.6 With regards to the trading of digital assets, pursuant to the DA Guidelines (read together with the RM Guidelines):
- (a) any IEO operator who seeks to facilitate the trading of digital assets on its platform shall first be registered as a DAX operator under the RM Guidelines;
  - (b) no DAX Operator shall facilitate the trading of any digital asset unless the SC has approved the trading of the said digital asset; and
  - (c) any digital token sought to be traded on any DAX platform shall require SC's prior approval.

At this juncture, the DA Guidelines does not spell out explicitly the assessment criteria for the SC to approve the secondary trading of digital tokens. Under the current regulatory framework, issuers may wish to bear in mind that secondary trading of digital tokens successfully launched on an IEO platform may not be absolute, as it remains subject to the nods of the SC and (at least one) DAX who is willing to facilitate the trading of the digital tokens.

#### **4. Perspective**

- 4.1 The introduction and implementation of a regulatory framework for digital assets is welcomed as it provides certainty and peace of mind to various interested stakeholders who seek alternative fundraising or investment avenues. We believe that the fundraising space in Malaysia will be further invigorated with the registration and operation of IEO platforms.
- 4.2 It is envisaged that once the fundraising avenue via IEO becomes more established in Malaysia, the secondary trading of digital tokens would be able to get under way as market participation in the digital assets space becomes more widespread.

- 4.3 We believe that the regulatory framework of digital assets in Malaysia is still being developed and we anticipate that further regulation may be introduced in the near future. For instance, at this juncture, any investments in digital assets offered on IEO platforms can only be purchased or invested with Ringgit Malaysia. To further stimulate the fundraising and investment activities in the digital asset space, certain stakeholders may wish to see that our regulators permit and regulate the use of recognised digital currencies for the purchase and/or investment in digital assets in the near future. Nonetheless, we note that this may require the joint effort by the SC and BNM in the establishment of a complete regulatory framework in that regard.

*In the next chapter of our Digital Assets Series (Chapter 2), we will discuss the characteristics of an IEO and the regulatory framework surrounding the operation of an IEO platform in Malaysia.*

***This legal update is for general information only and is not a substitute for legal advice.***

### Further Information

Should you have any queries as to how these developments may affect your business, please do not hesitate to contact us.



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