

SECURITIES TOKENS: A STUDY OF SECURITIES AND EXCHANGE LAW OF THAILAND

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Introduction

After the post-financial crisis in 2007, almost the capital market entities are struggling to deliver returns on equity from their cost of capital. It causes a problem for the start-up in seeking fund from the traditional commercial banks. The new trend for solving this problem is crowdfunding which is a replacement or addition to traditional seed capital sources.

Initial coin offering (ICO) or token crowd sale is one kind of the crowdfunding method to raise a fund via blockchain through a project or venture by creating and selling its Tokens in exchange for cryptocurrencies or liquid value such as Bitcoin or Ethereum.¹ This revolution is dealing with technology, and it changed the fundamental of the traditional financial business, it is a quite beneficial to the start-up to seek fund

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¹ Lawrence Lundy and Jamie Burke and Aron van Ammers, “All You Need to Know About Initial Coin Offerings,” Journal of Blockchain, at http://www.the-blockchain.com/docs/Initial_Coin_Offerings_Outlier_Ventures_Research.pdf, (last visited 28 August 2017).

because this kind of technology has centered on transparency, security, immunity, speed, and potential cost savings.²

Token crowd sale looks like the initial public offering (IPOs) which is governed by the Securities and Exchange Act of Thailand B.E.2535 (1992) (Thai Act). In the scheme that firstly, during token crowd sale offering, the investors can exchange their tokens or cryptocurrency for shares in a particular scheme; secondly, it refers to a project which is backed by the public for the first time; lastly, it has an authoritative guide which is similar to a prospectus. It is called “white paper” which shall be published by the issuers for the investors to read all information about their project and make decision to invest in such a project.

In Thailand, the Securities Exchange Commission (SEC) has power to monitor and govern the capital market under the Thai Act. Section 4 of the Thai Act defines a “security” by listing financial instrument which includes equity instrument and debt instrument for instance stock, bonds, debentures, notes, and transferable shares and also includes any other instruments as specified by SEC. This provision indicates that if such instrument is specified as a security, the transactions which involved securities are subject to the registration, mandatory disclosure, and intermediaries in securities transactions are subjected to SEC registration, rules, and supervision.

Nowadays, token crowd sale in Thailand is a new trend to raise fund; however at the period of this study the definition in the Thai Act doesn't play role in the token crowd sale. consequently the transaction are unregulated and unmonitored by the SEC and lead an effect by having raised fears of a potential bubble to the public who may suffer from damages that occurred from this kind of transactions. This is a big problem for the country because the definition under the Thai Act doesn't cover Token as securities, so it means that the SEC does not govern token crowd sale.

The Problem of the Study

² Kullarat Phongsathaporn, “Key Legal Issues to Riding the FinTech Boom,” The Next Fintech Trends, Thammasat University(Taphrachan) (15 August 2017):.3.

Token crowd sale is a new kind of financial transaction model which runs its process via distributed ledger or blockchain. This financial model becomes more popular as a new form of both investment opportunity and source of fund because this method can fill gaps and can fix the problems of entrepreneurs who have failed to raise capital through traditional source of fund because of firstly, most start-ups do not qualify under traditional capital financing since they are small and lack of financial background and secondly, there are too few venture capitalists versus the masses of start-ups who need money.³

The prosperity of this transaction makes a financial transaction to more complicated than before. And this kind of transaction becomes an issue because the regulatory structure of this transaction has developed without regarding to technology, and in contrast, technology continues to develop without regarding to the regulatory structure. Token crowd sale has played more role than before and causes an impact not only at the international level but also in local level including Thailand. People begin to recognize and invest their money in this kind of market and holding token as securities.

Token crowd sale causes a higher risk to retail investors because there is no specific provisions to govern and provide legal status for the tokens. However, the government, related institutions, and other authorities are well aware and warn about token crowd sale and try to manage or control this kind of investment.

At present, Thai government does not accept securities token that can be traded in the securities market. However, it is not illegal or forbidden. Nevertheless, the Bank of Thailand (BOT) which is the central organization that supervises the financial sectors of the country, issued comments about the information of Bitcoin which is included other kinds of cryptocurrencies in order to give awareness to the one who wants to invest in this kind of transaction. But there is no laws cover the token transactions in Thailand.

³ Richard Harrison, Crowdfunding and Entrepreneurial Finance, 1st ed. (United Kingdom: Routledge, 2016), p.54.

The Problem of Unregulated Token Crowd Sale

Lacking legislation can cause the problem to the investors in the token crowd funding sale; they are:

1. There is no Effective Law to Regulate the Digital Platform as Funding Portals

Token crowd sale takes a marketplace on a digital platform which comprised of many different platforms where the investor can convert the token unit into another or real currency. Many platforms are not subject to the securities and exchange regulations. Even if they play as dealer or broker in the traditional capital market.

2. No investor protection

This issue is firstly discuss, carefully research the platform and pay close attention to the free structure and systems safeguards because at present, there is no law to enforce token platform to be registered, and with the unregistered platform, it may not be able to protect against market abuses by other traders adequately.

3. The potential for fraud in money laundering

Token crowd sale has become a primary means of fundraising for projects built on blockchain technology. Every transaction of a blockchain-based token is permanently recorded on a public viewable digital ledger.⁴ Although the parties in such transaction associated with each other by secret identification, it is possible for investigators or the hacker to track down.

⁴ Saheli Roy Choudhury, It's a very good time to be a money launder, and you can thank cryptocurrencies, at <https://www.cnbc.com/2017/08/04/icos-may-be-seen-as-securities-by-u-s-and-singapore-regulators.html>, (last visited 17th January 2018)

Due to the nature of the token transaction which can raise sums of monies in a short time, it is vulnerable to money laundering and terrorist financing.⁵ With this innovation in technology, money laundering has embraced a universal character. The problem of money laundering is not only associated with drug trafficking or tax avoidance offenses but also increases the risk of each customer and business transaction.

Battle with money laundering and protect the investor from fraud token crowd sale needs some form of the regulation. At the worldwide level, the nations need to adopt an appropriate methodology, and the government in domestic level need to improve domestic legal structure; the regulation should also focus on the token crowd sale.

4. Inadequate Documentation

In the case that investors want to invest in the token transaction, as mentioned that, in Thailand, it has no regulation that regulates the promoter to give adequate information to the investors. But, it has “white paper” which is an authoritative report or guide which informs readers a complex issue and lay out facts about the blockchain or distributed application which describe how tokens work.⁶ The white paper is the similarity to the prospectus⁷ which is disclosure document that the

⁵ U.S. Securities and Exchange Commission, MAS clarifies regulatory position on the offer of digital token in Singapore, at <http://www.mas.gov.sg/News-and-Publications/Media-Releases/2017/MAS-clarifies-regulatory-position-on-the-offer-of-digital-tokens-in-Singapore.aspx>, (last visited 17 January 2018).

⁶ Rob May, Scrap the white paper : how to evaluate tokens and blockchain, at <https://www.coindesk.com/scrap-white-paper-evaluate-tokens-blockchains/>, (last visited 15 January 2018).

⁷ Section 4 Securities and Exchange act B.E. 2535.

issuer used to finalize sale until the registration statement has been efficiently declared by the SEC.⁸

Although token transaction has a white paper as a disclosure document for the individual investors to decide to invest in its transaction, it has no regulation to specify that which information the promoter should disclose to the investor, so sometimes it can be a kind of marketing. The investor of token crowd sale should educate themselves about the risk of lacking the information before getting involved and giving any money or personal information to a token platform. For the prospectus which are used for Initial Public Offerings (IPOs) required by the securities regulations to disclose both of hard and soft information. However, white papers are not regulated in the same line.

In addition to these issues, another concern especially cautioned by the BOT⁹ is on capital movements by the used of Token which may cause the impact to the society. This situation has led to the more attention to a status of a token in the aspect of law in Thailand.

After analyzing various applicable laws to find the proper legal measurements. The result is token transaction should be a security under the Thai Act because token crowd sale characteristic is like securities which is practiced in the capital market, but there is no law regulates this kind of transaction.¹⁰ To imply the appropriate regulations can protect the investors' interest.

Token under the Regulation of Securities Law in Foreign Countries

⁸ Section 72.

⁹ Notification of Bank of Thailand 8/2557.

¹⁰ Saheli Roy Choudhury, It's a very good time for money launder and you can thank crypto currencies, at <https://www.cnbc.com/2017/08/04/icos-may-be-seen-as-securities-by-u-s-and-singapore-regulators.html>, (last visited on 12th January 2018)

Today, there are some country implement the regulation on token crowd sale including the United States of America (USA) and Singapore. Thus, this section examine a token crowd sale regulation in the USA and Singapore in token crowd sale.

The United States of America

The United States of America implement the regulations on token crowd sale in... The law of the country include the term of token into the definition of securities both of federal and states law. In addition, The supreme court set up the legal principle which is called Howey test.

1) Howey test

After the court establish the Howey test principle, the SEC performs Howey test principle to identify securities token. There are four elements to test securities token, they are

(1) Investment can be in cash or non-cash. For instance, the exchange in token securities or any other property including other cryptocurrencies.

(2) A common enterprise which is the element which focuses on the success of investor interest rise and falls with other involved in the enterprise.

(3) The expectation of the return on their investment. For instance, capital gain or profits.

(4) The investors or buyers expect to earn from other investors

From the above elements, this principle has made the securities law in the USA flexible and modernity. With this characteristic of the USA law, if a token is concluded with all elements of Howey test, then token crowd sale is under the purview of the law. This gives a lot of benefits to investors who invest in this kind of investment in the sense that they can get the protection under the securities law.

Singapore

Singapore also implements regulations on token crowd sale. In Monetary Authority of Singapore (MAS) which is the authority that has a duty to oversight the securities regulation in Singapore, issued a regulatory framework to seek the safeguard for investors by setting out the general principle in the context of

collective investment scheme (CIS) which is a kind of securities. A result is if a token is concluding with all elements of CIS, then it shall constitute securities and shall subject to the provision of securities law.

In Thailand

According to the definition of the securities under section 4 of the Thai Act, the definition does not cover securities tokens. In addition, there is no general principle to test token transaction as practice in the United States of America and Singapore. Consequently determination whether token is securities is still unclear. As afore discussion token character is similarities to securities. Sofar there is no regulation and general principle to differentiate between equity tokens and utility tokens.

To determine the terms securities shall be considered section 4 of the Thai Act which cover only 9 items. The definition of securities on section 4 the SEA which states that “securities” means

- (1) treasury bills;
- (2) bonds;
- (3) bills;
- (4) shares;
- (5) debentures;
- (6) investment units which are instruments or evidence representing the rights to the property of a mutual fund;
- (7) certificates representing the rights to purchase shares;
- (8) certificates representing the rights to purchase debentures;
- (9) certificates representing the rights to purchase investment units;
- (10) any other instruments as specified by the SEC.¹¹

The information to prove that the definition of the securities of the Thai Act does not cover securities tokens.

¹¹ Section 4 Securities and Exchange Act B.E.2535.

Conclusion

A token is a kind of internet-based investment; it is the free movement of information which creates an issue in regulating the contents and its users. This characteristic may stick to the same problems as another kind of internet-based investment, for instance, fraud, money laundering, record keeping and hacker. Moreover, it could be stick with the issue of lacking enforcement in the sense that involving with tokens; it cannot enforce and supervise adequately.

However, there are some difficult legal questions surrounding token crowd sale, for instance, some tokens, depending on their features, may be subjected to securities law or another applicable law. The law is inconsistent among jurisdictions both in terms of definition and supervisions which are as follows:

1. Token as Securities

To determine that token is within the purview of the regulation of securities law or not, one should analyze the definition of securities in the securities law. From the study, in the United States of America and Singapore which have laws that one may use as a model law, these two countries have covered token in the definition of securities which are as follows:

In the United States of America, the SEC which is an authority that governed securities market already issued the report of investigation that some token that involved with “an investment contract” constitutes as security under section 2 (a)(1) of the Securities and Exchange Act,1934.

In Singapore, the MAS has issued “A guide to digital token offerings” to clarify some token that constitutes a capital market product is a security, and it must be regulated under the Securities and Futures Act (cap.289).

However, in Thailand, the definition of securities under the SEA which is the law that governs securities transaction in the securities market has not covered token as securities, so token transactions are not in the purview of securities law. This

can cause the risk of money laundering for the absence of the supervision from the administration by issuing any regulation.

2. The Regulation of Token Crowd Sale

Regulation is one of the most important questions regarding with token transaction. Token may fulfill functions of virtual currency, commodity, an investment instrument, company share and many others. The result is token quite difficult to define.

At present, the token is treated as security, but not all of the token are securities. There are two types of token which are security token and utility token.¹² Security-tokens are designed to be the company's share, while utility tokens represent access to company's product or services. Utility tokens are exempted from the regulations of securities law.

The legal concept of the security-token is to ensure that securities market will operate efficiently. The legal principle is based on the two primary goals which are first, to protect the consumer or an ordinary user of the securities to be safe and sound; secondly, to protect securities market by creating a market where the participants had equal access to the same information and subjected to the same rules.

Many countries try to develop their securities law to cover security-tokens by the inclusion of token in the definition of securities to grant the protection to investors in token crowd sale. A result is the projects which sell security-tokens during token crowd sale have to comply with the securities and exchange law then the regulation of securities shall apply token transaction and investor shall get protection under this law.

The key fundamental principle of securities law is to protect investors from having information adequately and reducing risk which may come from securities transaction. Although every investment has the risk, the securities law does not regulate every instrument. To get protection under the securities law, only the

¹² Bonpay, Security Tokens Vs. Utility Tokens, at <https://medium.com/@bonpay/security-tokens-vs-utility-tokens-1aa7531aabe8>, (last visited 3 April 2018).

transaction that involved with the instrument that constitutes as securities shall be in the scope of the law.

The promotor who issue token that constitutes as securities to public offering shall comply with the securities law, and their transaction shall be fall under the purview of the securities law which is as follows:

1) The disclosure requirement on white paper

In the securities law, there has disclosure requirement on prospectus which is the standard for the issuing company to comply with the public offering. This requirement is the most important provision for investors to have adequate information before deciding on their investment.

In addition to the issue, it involves with the document which called “white paper.” The white paper is defined as an authoritative report or guide that informs readers concisely about a complex issue and presents the issuing body’s philosophy on the matter. It is meant to help readers understand an issue, solve the problem or make decision.¹³

Although in token crowd sale, it has a white paper which is a simple description of the project, it has no law to govern it, so it is silent on important information. A result is many of token crowd sale are offered with inadequate disclosure of information. This can cause many problems as follows:

Firstly, investors in the token transaction could not identify the issuing entity’s or promotor’s origin when analyze token’s white paper to make a decision.

Secondly, lack of necessary information as to who stands behind the token crowd sale, the impact of right to claims for compensation under the law is severely limited, and if the parties to a transaction cannot be established with certainty, the law’s arms are tied.

¹³ Dirk A. Zetsche, Ross P. Buckley, Douglas W. Arner and Linus Fohr, “The ICO gold rush: it’s scam, it’s a bubble, it’s a super challenge for regulators” Law Working Paper Series 011 (2017): 10.

Thirdly, a whitepaper which is provided by promotor being incomplete, misleading, unaudited. It can lead to the high risk of fraud.

Lastly, the decision to invest in token crowd sale is lack of financial information; it can lead to problems of investors' decision to fund in such token crowd sale that it cannot be based on a rational of calculus.

According to the above problems, if a token is in the purview of securities law then the promotor shall comply with the disclosure requirement before public offering then investors in the token transaction shall have adequate information.

2) Antifraud preventive provision

Fraud is a broad concept that refers to any intentional act committed to secure an unfair or unlawful gain.¹⁴

In the scheme of securities law, there is an anti-provision to guarantee and protect the investing public against securities fraud and misrepresentation in the offer or sale of securities which shall arise in connection with prospectus and communications requirement.

A security-token shall be fall under the purview of securities law, so the antifraud provision shall govern this kind of transaction. A result is if there is illegal and prohibited action under the anti-fraud provision, the promotor in the token transaction shall be liable.

3) Civil liability

These measures are the essential procedures to control and monitor transactions to reduce the risk of investment. As a result, the promotor shall comply with the disclosure provision, provide adequate information as specified by the law on

¹⁴ Black's Law Dictionary defines fraud as, "An intentional perversion of truth for the purpose of inducing another in reliance upon it to part with some valuable thing belonging to him or to surrender a legal right; a false representation of a matter of fact, whether by words or by conduct, by false or misleading allegations, or by concealment of that which should have been disclosed, which deceives and is intended to deceive another so that he shall act upon it to his legal injury."

the whitepaper and shall not involve with the actions prohibited by the law which can lead to the civil liability.

3. Governing Platform

Token crowd sale is one kind of the crowdfunding method to raise a fund via Blockchain through a project or venture by creating and selling its tokens in exchange for cryptocurrencies. A blockchain technology is an electronically distributed ledger which similar to a stock ledger by maintaining various participant in a network of computers. The token crowd sale itself was expressly intended to serve as electronic raising fund through blockchain platform and to operate on the internet trade basis. The network enables users to transfer token directly to each other and settling those exchanges simultaneously without the involvement of any third party.

Token crowd sale does not have the central administrating authority, and it is not subject to control or supervision of any governmental bodies. Blockchain technology is used not only for token crowd sale but also transactions related to another kind of virtual currency¹⁵. The issue about the decentralized system causes the effect to the economic system in a way that makes it difficult to determine and oversight the token crowd sale transaction.

Recommendations

Every kind of investment has a risk that shall occur from it an ordinary transaction. Token crowd sale is one kind of investment which runs their process on

¹⁵ Prarya Apaiyanukorn, "Anti-money laundering against virtual currency in case of using Bitcoin," (Master degree, Faculty of Law, Thammasat University, 2015), p.28.

the internet platform. So from all aforesaid, I would like to propose the following recommendations in order to solve the problems as follows;

1. Amendment of the Definition of Securities in Securities Law to Cover Token

Due to the characteristic of token which is similar to security, the SEA should be the primary law to supervise and regulate the token to manage the risk of investment through a token transaction in the future. The other regulations have to be amended to be consistent with this act.

Moreover, it should treat token as securities because, in this scheme, it is used to raise capital funds and at the present, it tends to be used more widely to replace raising funds through the traditional commercial bank.

According to the SEA, the list in the definition of securities under section 4 may not cover token, so under section 4 (10), the SEC should to propose that token can be a new type of instrument which can constitute as securities and create a new regime for the token transaction. Then token transaction shall fall under the regulation of securities law, and SEC is an authority that has the power to monitor and govern token transaction to protect investors.

The SEC which is the regulator on securities transaction had to explore the punishment for the criminal based activities which caused the draining of fund or money laundering offense to restrict the illegal use of a token. The existing laws do not have the prohibition of the user of a token in the commission of a crime. If the regulators can inquire this supplement option to control and enforce on this subject matter, so the investors, companies, and platform operators shall be subjected to regulations and could be subjected to a penalty the same as another offence.

As for recommendation, the author suggests amendment to the Securities and Exchange Act (SEA) section 4(10) to add the definition of securities to cover “token” to affirm legal status of token under the securities law.

2. Governing Token Platform

Not all of the tokens can constitute as securities. There are two types of token which are security-token and utility-token. There are two approaches for such token; they are as follows:

1) Using an exempt regime option

This approach stands for the utility-token which cannot be governed by securities law, so it is not under securities law.

With a token process that is operated on the internet which is an open network, it is easily accessible by anyone through a digital process at fewer fees compared with traditional investment. This is a kind of innovative investment so that it can relate to various kinds of crimes.

The approach is as this scheme conduct through the internet; if the promoter of such platform already registered their platform, then it is a recognized platform. This recognized platform is easy to investigate, so there are exempt from the approval process and the disclosure requirements.

In this approach, if there is any fraud or false information that occurs, the case will not be subjected to the SEA but will be prosecuted through anti-fraud provision or anti-money laundering act.

2) The automatic approval

This approach stands for security-token. In this case, their transaction shall comply with the SEA. The SEC should amend the approval condition in the SEA to cover the registered platform, so the registered platform shall be automatically approved by SEC. As a condition for approval, the issuer of such platform must submit a required report and other documents related to token crowd sale to SEC at and after the offering.

In case of fraud or disclosure of false of information, the case shall be subjected to the SEA in addition to anti-fraud provisions.

