

REGULATION OF DIGITAL ASSET OFFERING AND TRADING IN MALAYSIA

Introduction

The blockchain technology has introduced the world to a digital distributed record-keeping system that is nearly impossible to hack. This nascent technology underlies the very creation and the implementation of digital assets by recording their provenance. Blockchain-powered digital assets are currently being offered and traded on various platforms, and with more entrepreneurs and investors showing interests in the market, countries worldwide are prompted to regulate the offering and trading of digital assets. In Malaysia, the offering and trading of digital assets as securities is regulated by the Securities Commission Malaysia (“**SC**”).

The Regulatory Framework of Digital Assets in Malaysia

Digital assets are recognised as securities under the Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019 (“**Prescription Order 2019**”), for the purposes of securities laws in Malaysia, if the criteria set out in the Prescription Order 2019 are satisfied. Digital assets come in many forms, but under the Prescription Order 2019, digital assets are categorised into two particular types which are **digital currency** and **digital token**.

The term **digital currency** is defined under the Prescription Order 2019 as 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 money.[1] Meanwhile, the term **digital token** is defined as a digital representation which is recorded on a distributed digital ledger, whether cryptographically-secured or otherwise.[2] Accordingly, any digital assets which are not recorded on a distributed digital ledger do not fall under the purview of the Prescription Order 2019. It is also worth noting that, as the law

currently stands, privately-issued digital assets are not recognised as a legal tender or as a form of payment instrument in Malaysia.[3]

Under the Prescription Order 2019, a digital currency is deemed to be a security for the purposes of securities laws if:

(a) it 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;

(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 currency; and

(c) it is not issued or guaranteed by any government body or central banks as may be specified by the Commission, is prescribed as securities for the purposes of the securities laws.

Meanwhile, a digital token is deemed to be a security for the purposes of securities laws 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.[4]

Digital Asset Offering

The offering of digital assets as securities in Malaysia must be conducted through a recognised Initial Exchange Offering (“**IEO**”) platform that has been registered with the SC. In simple terms, IEO is a digital fundraising mechanism in which an issuer offers digital tokens to investors in exchange for funds.

In regulating the issuance of digital assets for fundraising through IEO platforms, the SC has issued the **Guidelines on Digital Assets (“DA Guidelines”)** pursuant to the Capital Markets and Services Act 2007 (“**CMSA 2007**”). The DA Guidelines set out the eligibility requirements to be met by applicants and the criteria and obligations to be fulfilled by IEO operators and issuers of digital assets.

Eligibility and Registration Requirements

Unless otherwise specified by the SC, only a Malaysia-incorporated company with a minimum paid-up capital of RM5 million may be registered as an IEO operator in Malaysia. [5] If the IEO operator is a public company, at least one of its directors must be an independent director.[6] Further, the SC must also be satisfied that:

- (a) the applicant, its directors, controller, and senior management are fit and proper;
- (b) the applicant will be able to carry out its obligations as set out under the DA Guidelines;
- (c) the applicant will appoint at least one responsible person as required by the DA Guidelines;
- (d) the applicant will be able to manage risks associated with its business and operation including demonstrating the processes and contingency arrangement in the event the applicant is unable to carry out its operations;
- (e) the applicant has sufficient financial, human, and other resources for its operation at all times; and
- (f) the applicant has appropriate security arrangements which include maintaining a secured environment pursuant to the SC's guidelines for the management of cyber risk.[7]

All issuers seeking to raise funds on SC-approved IEO platforms ("**Issuer**") must also fulfil the requirements set out in the DA Guidelines. In terms of eligibility, only a Malaysian-incorporated company or a limited liability partnership ("**LLP**") which operates its main business operations in Malaysia, and that exclusively raises funds through IEO, may be an Issuer.[8] In respect of financial requirements, all Issuers except for LLPs are required to have a minimum paid-up capital of RM500,000 and are required to maintain shareholders' funds of RM500,000 at all times.[9] Where the Issuer is an LLP, it must have a minimum capital of RM500,000 maintained at all times.[10] Additionally, it is also worth noting that an IEO operator seeking to operate a digital asset exchange ("**DAX**") platform in Malaysia must also register as a DAX Operator with the SC.[11]

Digital Asset Custody

Under the DA Guidelines, an IEO operator also bears the following obligations in relation to its investors' digital tokens:

- (a) to ensure that the token holders' digital tokens are properly segregated and safeguarded from conversion or inappropriate use by any person;
- (b) to establish and maintain a sufficiently and verifiably secured storage medium designated to store digital assets from investors; and

(c) to establish system and controls for maintaining accurate and up-to-date records of client's digital assets held.[12]

In performing these obligations, an IEO operator may appoint a Digital Asset Custodian ("**DAC**") registered with the SC to provide custody for the digital tokens, or alternatively, it may opt to provide its own custody services. The DA Guidelines define DAC as a person who provides services such as safekeeping, storing, holding, or maintaining custody of digital assets for the account of another person, and such services constitute capital market services for the purposes of Section 76A of the CMSA 2007.[13] A person who merely offers a system by whatever means, which enables an asset owner to hold the digital assets, and the asset owner has full control over his digital assets, is not deemed to be a DAC for the purposes of the DA Guidelines.[14] It is to be noted that an IEO operator who wishes to provide custody for the digital tokens of token holders must be registered with the SC as a DAC, in addition to being registered as an IEO operator.

A DAC may be either a local or foreign entity. However, if the applicant is a foreign entity, the SC must be satisfied that:

(a) the applicant is authorised to operate or carry out an activity of a similar nature in the foreign jurisdiction;

(b) the applicant is from a comparable jurisdiction with whom the SC has regulatory arrangements on enforcement, supervision and sharing of information; and

(c) it is in the best interest of Malaysia to register the foreign DAC.[15]

Digital Asset Trading

On July 30, 2021, Binance, one of the world's largest cryptocurrency exchange operators, was issued a public reprimand by the SC for illegal operation.[16] The trading of digital assets in Malaysia would be legally permitted if it is conducted through an SC-approved DAX platform. Pursuant to Sections 7(1) and 34(1) of the CMSA 2007, a DAX operator must be registered as Recognized Market Operators ("**RMO**") with the SC before it can lawfully function as a DAX operator in Malaysia.

Eligibility and Registration Requirements

The registration of RMOs is facilitated through the **Guidelines on Recognized Markets** issued by the SC ("**RMO Guidelines**"). The term DAX is defined under the RMO Guidelines as an electronic platform which facilitates the trading of a digital asset.[17] To be eligible as a DAX operator, the applicant must be a Malaysia-incorporated entity and has a minimum paid-up capital of RM5 million.[18] If the applicant is a public company, at least one of its board members must be independent.[19] Additionally, a DAX operator may be registered as an RMO if the SC is satisfied of several other criteria including, but not limited to:

- (a) the applicant will be able to operate an orderly, fair, and transparent market;
- (b) the applicant will be able to carry out its obligations as set out under the RMO Guidelines;
- (c) the applicant has furnished true and not misleading information and documents to the SC;
- (d) the applicant is not in the process of being wound up or dissolved and has not entered into a compromise or scheme of arrangement with its creditors;
- (e) no receiver or its equivalent has been appointed in respect of the applicant's property;
- (f) the applicant's directors, CEO and key responsible persons are fit and proper;
- (g) the applicant's business model has a clear or unique value proposition or will contribute to the overall development of the capital market;
- (h) the applicant will appoint at least one responsible person;
- (i) the applicant will set a fair and transparent set of rules for its DAX;
- (j) the applicant will be able to take appropriate action against a person who is in breach;
- (k) the applicant will be able to manage risks associated with its business and operation;
- (l) the applicant has sufficient financial, human, and other resources for the operation of its DAX; and
- (m) the applicant has put in place appropriate security arrangements pursuant to the SC guidelines on management of cyber risk.[20]

If the applicant is a foreign operator, in addition to the above, it must also show to the SC that:

- (a) it has been authorised to operate a stock or derivatives market or a similar activity in a foreign jurisdiction;
- (b) it is from a comparable jurisdiction with whom the SC has regulatory arrangements on enforcement and supervision; and
- (c) it is in the best interest of Malaysia to register the foreign operator as an RMO.[21]

DAX operators are restricted from facilitating the trading of any digital assets without the approval of the SC.[22] They are also prohibited from providing financial assistance to their investors and to invest or trade in digital assets on its platform.[23] Additionally, DAX operators are required to formulate a DAX-specific conflict of interest management procedure,[24] to establish an internal audit function,[25] to identify possible sources of

operational risks for risk mitigation purposes,[26] as well as to operate with a high degree of security and operational reliability.[27]

Further, the RMO Guidelines also prescribe an obligation for DAX operators to preserve market integrity through maintaining transparency in performing their functions, maintaining adequate procedures in respect of their trading activities, and through protecting their investors' assets in the manner required under the RMO Guidelines.[28] To this end, DAX operators are obliged to disclose information about its market structure, order types, and the interactions of the order types on the platform, among others.[29]

Conclusion

In conclusion, the offering and trading of digital assets as securities are legally permitted in Malaysia, subject to the regulatory requirements governing these activities. Given the rapid development of the digital asset regulations worldwide, all prospective market participants are advised to seek legal consultations on all applicable laws and procedures in the relevant jurisdiction before entering the market.

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1. Section 2 of the Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019
 2. *ibid.*
 3. "BNM and SC's Joint Response on "Policy Confusion Over Cryptocurrencies" (Bank Negara Malaysia, December 16, 2020)
 4. Section 3 of the Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019
 5. Guidelines 13.04 and 14.01 of the Guidelines on Digital Assets
 6. Guideline 16.01 of the Guidelines on Digital Assets
 7. Guideline 15.01 of the Guidelines on Digital Assets
 8. Guideline 6.02 of the Guidelines on Digital Assets (excluding exempt private and public listed companies)
 9. Guideline 6.03 of the Guidelines on Digital Assets
 10. *ibid.*
 11. Guideline 13.02 of the Guidelines on Digital Assets
 12. Guideline 17.15 of the Guidelines on Digital Assets
 13. Guideline 23.01 of the Guidelines on Digital Assets
 14. *ibid.*
 15. Guideline 23.05 of the Guidelines on Digital Assets
 16. "SC Takes Enforcement Actions on Binance for Illegally Operating in Malaysia" (Securities Commission Malaysia, July 30, 2021)
 17. Guideline 15.01 of the Guidelines on Recognized Markets
 18. Guideline 15.03 of the Guidelines on Recognized Markets
 19. Guideline 15.05 of the Guidelines on Recognized Markets
 20. see Guideline 3.01 of the Guidelines on Recognized Markets for the full requirements
 21. *ibid.*
 22. Guideline 15.14 of the Guidelines on Recognized Markets

23. Guideline 15.07 of the Guidelines on Recognized Markets
24. Guideline 15.06 of the Guidelines on Recognized Markets
25. Guideline 15.13 of the Guidelines on Recognized Markets
26. Guideline 15.08 of the Guidelines on Recognized Markets
27. *ibid.*
28. Guidelines 15.22 to 15.23 of the Guidelines on Recognized Markets
29. Guideline 15.23 of the Guidelines on Recognized Markets

Written by:



Ili Syazwani Shairi

Associate

ilisyazwani@azmilaw.com

*** Nor Azdiana Aniza Ahmad Nizam and Maryam Naqibah Mohd Adam had also contributed to this research.*

Corporate Communications

Azmi & Associates

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