

Statement on Security Token Offerings

28 March 2019

This statement serves as a reminder about the legal and regulatory requirements applicable to parties engaging in security token offerings (STOs). The Securities and Futures Commission (SFC) also wishes again to remind investors to be wary of the risks associated with virtual assets, including tokens which are the subject of STOs (Security Tokens).

Regulation of STOs

STOs typically refer to specific offerings which are structured to have features of traditional securities offerings, and involve Security Tokens which are digital representations of ownership of assets (eg, gold or real estate) or economic rights (eg, a share of profits or revenue) utilising blockchain technology. Security Tokens are normally offered to professional investors only.

In Hong Kong, Security Tokens are likely to be "*securities*"¹ under the Securities and Futures Ordinance (SFO) and so subject to the securities laws of Hong Kong.

Where Security Tokens are "*securities*", unless an applicable exemption applies, any person who markets and distributes Security Tokens (whether in Hong Kong or targeting Hong Kong investors) is required to be licensed or registered for Type 1 regulated activity (dealing in securities) under the SFO. It is a criminal offence for any person to engage in regulated activities without a licence unless an exemption applies.

Intermediaries which market and distribute Security Tokens are required to ensure compliance with all existing legal and regulatory requirements. In particular, they should comply with paragraph 5.2 of the Code of Conduct² as supplemented by the Suitability FAQs³. Under the Guidelines on Online Distribution and Advisory Platforms and paragraph 5.5 of the Code of Conduct⁴, Security Tokens would be regarded as "complex products" and therefore additional investor protection measures also apply.

Further, intermediaries are expected to observe requirements which are similar to those set out in the Circular to intermediaries on the distribution of virtual asset funds dated 1 November 2018. The requirements are highlighted as follows:

(A) Selling restrictions

Where an intermediary markets or distributes Security Tokens, it must be licensed or registered for Type 1 regulated activity (dealing in securities) and the Security Tokens should only be offered to professional investors.

(B) Due diligence

Intermediaries distributing Security Tokens should conduct proper due diligence in order to develop an in-depth understanding of the STOs. This should include, but is not limited to, the background and financial soundness of the management, development team and issuer as well as the existence of and rights attached to the assets which back the Security Tokens. Intermediaries should also scrutinise all materials relevant to the STOs including published information such as the whitepaper and any relevant marketing materials. Intermediaries should also ensure that all information given to their clients is accurate and not misleading.

(C) Information for clients

To help clients make informed investment decisions, intermediaries should provide the information in relation to STOs in a clear and easily comprehensible manner. Intermediaries should also provide prominent warning statements covering risks associated with virtual assets.

Intermediaries are reminded to implement adequate systems and controls to ensure compliance with the requirements before they engage in the distribution of STOs. Failure to do so may affect their fitness and propriety to remain licensed or registered and may result in disciplinary action by the SFC.

Intermediaries are reminded to discuss with the SFC before engaging in any activities relating to STOs⁵.

Investor warnings

Investors are urged to be wary of the potential risks involved in virtual assets. The SFC has repeatedly reminded investors that virtual assets are exposed to heightened risks of insufficient liquidity or volatility, opaque pricing, hacking and fraud. These risks are also applicable to Security Tokens. As STOs are a nascent form of fundraising and the market is still evolving, investors should be cautious when deciding whether to invest. Investors may be exposed to significant financial losses in trading Security Tokens. If investors cannot fully understand the risks and bear the potential losses, they should not make an investment.

Please contact the SFC Fintech Contact Point at fintech@sfc.hk for enquiries relating to this statement.

Intermediaries Division
Securities and Futures Commission

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¹ As defined in section 1 of Part 1 of Schedule 1 to the SFO.

² The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

³ The Frequently Asked Questions on Compliance with Suitability Obligations by Licensed or Registered Persons and the Frequently Asked Questions on Triggering of Suitability Obligations.

⁴ To be effective in July 2019.

⁵ Please refer to the Circular to intermediaries on compliance with notification requirements dated 1 June 2018 for details.