Blockchain and the Financial Markets

Security Token Offerings (STO)

Disclaimer

› All information provided in this lecture and presentation is given without warranty as to its accuracy or completeness.

› This presentation is meant for the personal use of the recipient only.

› Neither this lecture nor this presentation constitute legal advice.

› You must independently seek legal advice in regards to any matter of personal concern.

Thomas Feldkircher

> Partner at NÄGELE Attorneys at Law, LLC

> Head of Banking and Capital Markets Law Department

Agenda

› Intro to The Principality of Liechtenstein

› Token Standards

› Will the Digital Economy be a Token Economy?

› Token Offerings

› STOs in Practice

› Advantages of Liechtenstein as a Business Location

FMA
Financial Market
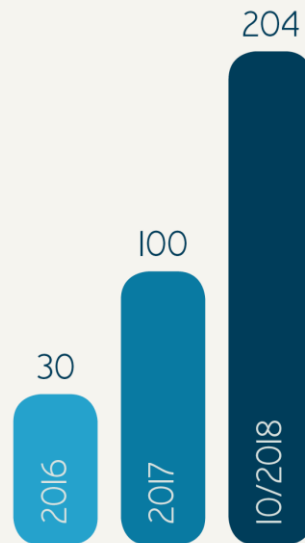Authority

Open Minded

Regulatory
Laboratory

Intro to The Principality of Liechtenstein

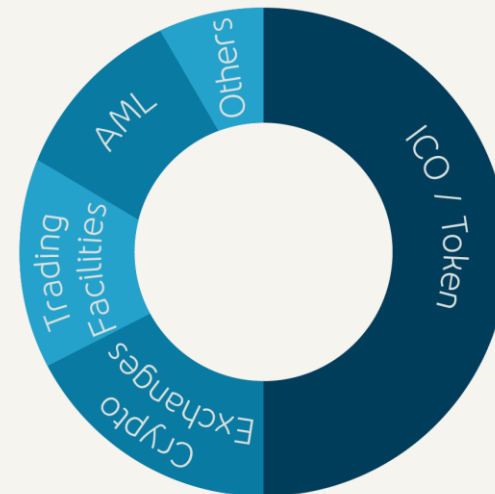© Liechtenstein Marketing / Filmfabrik Anstalt

Quelle: https://www.youtube.com/watch?v=RQeyBihzY1E

What was Happening in Liechtenstein 2018?

Number of FinTech requests to FMA

- 2016: 30
- 2017: 100
- 10/2018: 204

Hot Topics 2018

- ICO / Token
- Crypto Exchanges
- Trading Facilities
- AML
- Others

What is Happening in Liechtenstein?

› On August 30th, 2018, the FMA approved, for the first time, a prospectus for a „Security Token".

- According to our information, this is the first officially approved public offer of a security token in EEA/EU Framework.
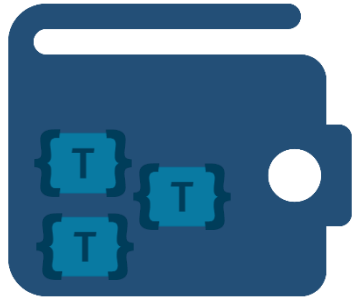
NÄGELE

Finance and Law

Institutions, Regulators and Contact centers

Platforms, Exchanges and investment solutions

Conferences / Events / Associations

Blockchain and Crypto solution providers

supporters

BANK FRICK LIECHTENSTEIN

NÄGELE Rechtsanwälte

UnionBank

kaiser.partner

FMA Finanzmarktaufsicht Liechtenstein

UNIVERSITÄT LIECHTENSTEIN

Grant Thornton An instinct for growth

OWV

area2Invest

daura

Blocktrade.com

LIGHT 47

CCA

TECHNOPARK LIECHTENSTEIN

BLOCKCHAIN MEETUP LIECHTENSTEIN

FINTECH.LI

finance forum liechtenstein

INVESTOR SUMMIT

CRYPTO WORLD PARTY

CRYPTO INSURANCE

BY GRAF & PARTNER

æternity

OWV

TenX

LIGHT 47

weeve

ICO.li

CRYPTOMEDIA BLOCKCHAIN AND ICO MARKETING

GANTEN GROUP

itcc.li IT Crowd Club Liechtenstein

PINK LEMON

Challenges for Security Token

New Standards for Security Tokens?

> ERC20, ERC721, ERC1400:

Wallet A

Transfer Verification Functions
(Transfer, Whitelist (KYC, AML,…), add.
Filter, Burn)

Wallet B

The legal nature of Tokens

Token as Information

› A **token** is information that

- Represents an underlying (right), or
- Does not have any underlying (e.g. Bitcoin).

› **Underlying**, for example:

- Access right to a network
- Discount on the purchase of a service or product
- Right of Claim or membership in respect to a legal entity
- Title to an object

Functions of Tokens:

〉 In particular, tokens have the following functions:

Legitimization
(for the benefit of the beneficiary or creditor)

Liberation
(in favor of the debtor)

Transportation
(Transfer of the underlying right)

Nature of Tokens under Civil Law

› The information on the data storage system (DLT/Blockchain) is immaterial.

- Pursuant to Liechtenstein legal doctrine and jurisprudence, tokens are not objects/tangible chattel under its property law.

- Therefore, in the draft of the TTTL (Token and Trusted Technologies Law; Blockchain Act), tokens were defined independently and subjected to their own regulation of transfer.

- Tokens as dematerialized securities.

Regulatory Assessment of Tokens

› An assessment under financial market law is based on the underlying that the token represents:

- If a financial instrument pursuant to the MiFID II / Banking Act is represented by a token (so-called security token), all provisions relating to financial instruments must be observed (e.g. obligation to publish a prospectus).
- If no financial instrument is represented, but the token represents a claim against the issuer, which is issued against payment of an amount of money in order to use the token to make payment transactions with third parties, then e-money is given (so-called stable coins).
- If neither is the case, the token structure does not indicate any financial market implications (so-called utility token or currency coin).

Caveat

> Even if the token structure does not entail any obligations under financial market law, the business model may entail licensing obligations:

- Example: A token represents the right to a discount on an insurance premium. The token structure as a "discount voucher" does not raise any regulatory concerns, but the insurance business is subject to authorization.

Token Offerings

Regulatory assessment

› If tokens representing a financial instrument (so-called security tokens) are issued in the token offering, obligations under financial market law apply, e.g:

- Obligation to publish a prospectus when conducting a public offering
- Underwriting and/or placing of financial instruments are subject to a license

› If no such tokens are issued in the token offering, there are only general obligations under civil law to provide information (potentially leading to an information asymmetry).

Security Tokens in Liechtenstein

› The Liechtenstein Understanding: Tokenized Financial Instruments

› Tokens that are issued on a blockchain, representing underlying rights.

› Equity Instruments (*equity-based*): shares in a stock corporation or similar instruments with participation rights (participations of profit participation certificates)

› Debt instruments (*debt-based*): Notes/Bonds

› Derivative instruments

Legal Requirements

› If a token is a security within the meaning of the Securities Prospectus Act (WPPG), then there might be an obligation to publish a prospectus.

› Instances where a prospectus is required:

- Issuance volume of over € 5 Million in 12 months (over € 8 Million after the Prospectus Regulation enters into force in July 2019).
- Public Offering (150 or more investors per EEA Member State, not limited to qualified investors)
- Minimum denomination or minimum purchase price underneath € 100'000.00

› The prospectus is to be approved by the FMA

› Passporting in other EEA/EU states is possible (Notification)

Exemptions from the Prospectus Obligation

> No Public Offering (*private placement*)
>
> - This includes instances where the sale is only carried out on the investor's initiative
> - Nevertheless a private placement memorandum is recommended

> Offer is only aimed at qualified investors

> Issue volume below € 5 Million (below € 8 Million under the new Prospectus Regulation)

> Less than 150 investors per EEA State

> Minimum denomination or minimum purchase price over € 100'000.00

> Exceptional requirements are also possible

Technical Requirements

› The following technical mechanisms or precautions should be implemented in the framework of an STO:

- Whitelisting the Token Acquirer (KYC)
- «Burn»-Mechanism (burning of the token, enforcement)
- Buyback Function
  - Buyback of tokens via a Smart Contract
  - In particular, in the case of debt instruments such as bonds of significance
  - Can also be connected to the burn function (*buy back and burn*)

Benefits of Using DLT

› Blockchain properties: protection against manipulation, immutable transaction history, security, corporate covernance

› Implementation of smart functions

› Clearing via Smart Contract

› Immediate execution of transactions

› No need for intermediaries, custodians, etc.

Distribution and Trading of Security Tokens

> The distribution (≠ offering) and trading of security tokens (financial instruments) is reserved for licensed banking institutions and investment firms.

> Matched-Principal-Trading (operating an exchange) with regard to security tokens requires an additional license on top of an investment firm as an MTF (multilateral trading facility) or OTF (organized trading facility).

STOs in Practice
Three examples of approved Security Tokens in Liechtenstein

NEX Token (1)

> Issuer: NEON EXCHANGE AG

> Business Model: Exchange office, matching, exchange (NEX Exchange),

> First approved security token in Europe (August 2018)

> Token represents participation rights

> Participation of revenues

> Entitlement to a pro rata share of fee income from the operation of the Exchange (staking procedure)

Weitere Informationen: https://nash.io/

NEX Token (2)

› Token holders receive dividends

- Depending on the token held and resulting charges

› Equal ranking to the claims of other NEON EXCHANGE AG creditors

› <u>No</u> entitlement to ongoing payments, repayments, or withdrawal of tokens

› NEX tokens can be traded via the NEX Exchange

Weitere Informationen: https://nash.io/

IVO Token (1)

› Issuer: INVAO Trading AG

› Business Model: Arbitrage trading using proprietary trading software

› Token: Derivative securities; freely transferrable and tradeable

› Profit for token holders from expected increases in value of IVO token, and thus from expected difference between issue price and sale or repurchase price at maturity. (**Zero-Bond**)

Weitere Informationen: www.invao.org

IVO Token (2)

> Indirect participation in the annual profit from trading turnover on the basis of the bond.

> 20% reserve of the annual profit to carry out the buy back and burn (repurchase and «burning» of tokens)

Weitere Informationen: www.invao.org

edeXa Token

› Issuer: edeXa AG

› Business Model: Development and offering of a supply chain based blockchain to companies (Blockchain as a service technology)

› Token: **Non-voting shares – Participation Certificates**(Art. 304a ff. PGR)
  - 10 Million bearer participation certificates, participation captial CHF 100,000 issued against contribution
  - Only one representative recognized for each bearer participation certificate
  - No right to vote, but right to bring agenda items to the AGM
  - Participation requires entry into the participation register

› With profit distribution: increased share of distribution to shareholders

Weitere Informationen: www.edexa.io

Advantages of Liechtenstein as a Business Location

Advantages for Carrying out an STO

Advantages of a STO in Liechtenstein (1)

> Equal regulatory treatment of financial instruments and their tokenized counterparts (technology neutral approach)

> Recognition of book-entry securities in the Liechtenstein legal system.
  - No need for the securitization of membership rights and corporate claims in a security.

> Transmission of tokens and the rights represented by them via form-free assignment.
  - No written form requirement for declaration of assignment (other than in Switzerland)
  - Notification to debtor sufficient
  - Purely blockchain-based transfer is legally unproblematic

Advantages of a STO in Liechtenstein (2)

› Securities Prospectus: Passporting to all EU/EEA States is possible

- Only one authorization procedure required
- Large coverage area for the offer, which corresponds to a large potential circle of investors

› Business relationships with banks

- Several established banks with extensive experience in the ICO/STO sector
- Establishing a business relationship is relative simple

› Creation of legal security within the framework of the token economy through the upcoming TTTL (Token and Trusted Technologies Law, a.k.a. Blockchain Act)
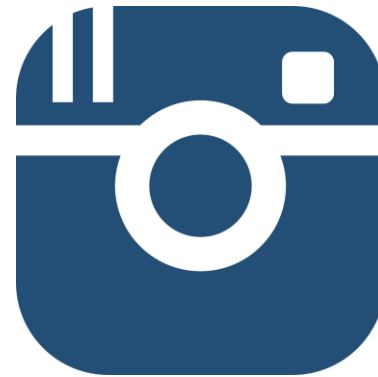
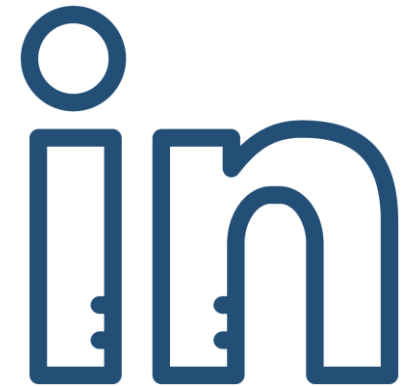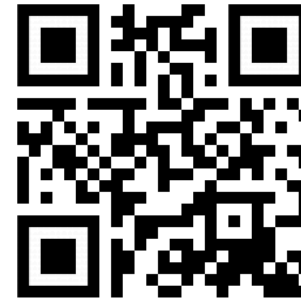# Like us...

Facebook
nlaw.li/facebook

Twitter
nlaw.li/twitter

Instagram
nlaw.li/instagram

linkedin
nlaw.li/linkedin

Questions?

> Contact me by E-mail:
tf@naegele.law

> Find our blog at www.naegele.law/blog

Thank you very much for your time!

NÄGELE Attorneys at Law LLC | Dr. Grass-Strasse 12, 9490 Vaduz | T +423 237 60 70 | tf@naegele.law