

# Security Tokens are Shaping the Future of Wealth Management in Southeast Asia

*The last 12 months has seen the meteoric rise and fall of the quintessential cryptocurrency - Bitcoin (BTC) - from its peak at close to \$20,000 in December 2017 to its more than 80% drop to ~USD3600 today. At the same time and certainly in (negative) correlation to, there has been a rise in interest in Security Tokens or Security Token Offerings (STOs).*

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**WHAT ARE SECURITY TOKENS AND DO YOU NEED**  
to embrace or even understand blockchain or cryptocurrency to benefit from STOs? We will explore the definition, the mechanism and the benefits of Security Tokens when it comes to wealth management in Southeast Asia.

In Asia, Southeast Asia particularly, we are seeing the rise of a new class of younger mass affluent investors who value customization, flexibility and cost efficiency in wealth management. This generation will continue to grow and is expected to reach 136 million population by 2030.

Furthermore, these investors are digitally savvy - 64% of the mass affluent in ASEAN countries are under the age of 40 and 24% are under the age of 25.

Blockchain and tokenization can shape the future of wealth management, by allowing superior access and liquidity through the concept of STOs backed by real assets.

Interestingly, December marked the 10th anniversary of Bernie Madoff's arrest, which uncovered a deception lasting over 30 years costing investors over USD65 billion. If blockchain did exist back then, the complex web of accounting fraud may have been prevented. By tokenizing investments and putting all transaction information on the blockchain, all relevant records are visible to investors, regulators, and auditors. And because of the immutability, the fund manager will not be able to fake or change the data.

STOs also promote good behavior in the financial ecosystem, as transparency continues to be a key theme in the industry.

### So what is a Security Token?

Security Tokens are securities and fulfill the definition of such according to the Howey Test. Security Tokens are digital representations of ownership over an asset - this can be funds, equity, debt, physical assets, etc. Just like paper-based certificates for equities or bonds can be issued to investors, tokenized securities can be issued using blockchain.

Most Initial Coin Offerings (ICOs) argue their tokens are utilities (i.e. provide the user with access to a service or ecosystem) and not securities. However, buyer beware as more than 80% of ICOs in 2017 have been found to be fraudulent and most have used ICOs as a get-rich-quick fundraising scheme.

On the contrary, Security Tokens have to be compliant with existing securities regulations. Its value is derived from an underlying asset; subsequently, it is subject to government laws controlling traditional securities. To issue security tokens, issuers need to do all the necessary paperwork, and only investors who have undergone proper KYC and AML compliance have a right to buy and trade them.

### Smart Contracts

Smart contracts is also an important component of Security Tokens. A Smart contract is a computer program that can be deployed on blockchain that "not only define the rules and penalties around an agreement in the same way that a traditional contract does, but also automatically enforces those obligations."

Running smart contracts on blockchain yields two benefits: First, it gives a complete transparency of rules and records. Second, the rules and records become immutable. Once the code is deployed on blockchain, no one, including the person who has written it, can modify or delete it.

Traditional financial systems require various intermediaries such as registrars, custodians, brokers, market makers, clearing houses, etc. to monitor each other and prevent fraud. And since each stakeholder runs their own system and database, they need to validate the information coming from another party, often manually. By using smart contracts for one master set of rules and obligations among the stakeholders, it eliminates various reconciliation processes and inefficiencies.

### What does it mean for Asian investors?

There are four key benefits we see for investors:

#### ■ 1) Greater Liquidity

With the reduced settlement time, greater flexibility, and easier access to international investors, the liquidity of private securities is expected to improve dramatically. In the alternative investment secondaries market, assets trade at a 20 - 30% discount typically because there is so much paperwork and intermediaries involved. With the implementation of Security Tokens, investors can freely trade assets with a much thinner liquidity discount.

#### ■ 2) Reduced Settlement Time

In traditional financial exchanges, one can execute transactions quickly, but it takes at least two days until the transfer of ownership is settled. This is because, as mentioned above, it requires various reconciliation processes and middlemen. By eliminating some of these, if not all, blockchain can complete the settlement in real-time.



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### ■ 3) Fractional Ownership

The lower operational cost creates more flexible trading opportunities for investors. First, private assets can be tokenized and divided into much smaller scale (fractional ownership), and they become tradable among investors. A successfully 30-year-old investment banker in Singapore may not be able to afford an entire condominium but can certainly purchase 1/100th ownership of a luxury condominium and participate in the upside through a Security Token.

### ■ 4) Easier access to International Investment Opportunities

Since all the rules become programmable and transparent to the regulator, it will be easier for investors to invest in private securities in other countries. Many young investors in the Philippines have expressed excitement for a way to access foreign investment opportunities. For instance, if a smart contract saying “Filipino investors need to meet criteria X, Y and Z to be able to invest into security#123” is deployed and audited by the regulator in advance, the Filipino investors will be able to check their qualification instantly based on the KYC they have undergone beforehand.

### **The growth of security token trading platforms**

The STO market is evolving month by month. The latest development is the growth of security token exchanges. Security token trading platforms is generally a more cost-efficient way to provide liquidity to investors through a secondary market.

Although Security Tokens have great potential to improve liquidity, the supporting ecosystem is still in its nascency.

This is especially true for security token trading platforms. Since almost all existing cryptocurrency exchanges are not licensed for Security Token trading, there is no way to ensure proper compliance.

Regulated security token trading platforms are a must in order for the wealth management industry and the secondary market for security tokens to thrive. There will need to be greater education and understanding of the mechanisms behind security token trading platforms - and how it will benefit investors in the end.

There are dozens of security token trading platforms globally awaiting licenses but very few have obtained one. Mainly because most regulators struggle with whether to place these trading platforms under existing stock exchange rules or develop a new set of rules.

We do see today that governments are becoming more open to the concept. The firms that have received licenses to operate security token trading globally include Binance (sandbox with Malta), Xen (Mauritius regulatory sandbox license) and Securrency (Abu Dhabi RegLab). Compliance with a regulatory framework is key to facilitating adoption of security tokens in the broader wealth management industry.

### **The future of wealth management is powered by blockchain and tokenization**

Security tokens can be a solution in providing liquidity and access to over USD100 trillion of illiquid assets. This will shape wealth management for Southeast Asia’s young, digitally savvy affluent investors, who seek transparency and control.

Tokenization and blockchain can also open up traditionally illiquid markets such as hedge funds, private equity funds, and venture funds to affluent investors while offering regulators compliance and transparency at the same time.

It’s also important to note that we are seeing more STO projects launching or about to launch. As an investor, it is important to look for projects with a good team (backgrounds in finance, compliance, security) and proper licensing from regulatory authorities.

At Xen, we see that the future of wealth management in Southeast Asia will be powered by blockchain and tokenization for the greatest efficiency, transparency and liquidity. ■