

Tokenization Standards Association

Tokenization Standards

I. Preamble

In striving to uphold and improve the reputation of the global blockchain community, to effectively contribute to the protection of investors, to add to the integrity of the market, and with the intention of making an effective contribution to the development of the regulatory framework and best practices, the Tokenization Standards Association (hereinafter “TSA” or the “Association”), as the industry association undertaking the safeguarding of the interest and reputation of the market participants, has issued the due diligence standards for persons engaged in the tokenization of assets and token generation events (“TGE”) (hereinafter referred as the “Standards”).

II. Scope

The scope of the Standards is determined in accordance with TSA’s articles of association and is defined by the following areas of application:

- Technology;
- Blockchain regulation;
- Legal and tax;
- Anti-money-laundering compliance;
- Investor protection;
- Trading.

In order to achieve its purpose, the Association will promote the dialogue between professionals among themselves and with the members of the industry, grant titles to members and establish as well as supervise the relevant criteria. In particular, the Association shall award the title of **TSA Qualified Token Issuer** pursuant to compliance with the Standards set in the present document to members that wish to obtain such status. Requirements, terms and process for requesting the status are set in separate document.

III. The Standards

1. Definitions

1.1 Token

“Token” means a digital unit resulting from the records in blockchain or other type of distributed ledger.

The basic technical feature of a Token is transferability. A Token may be generated on the ground of a protocol (protocol token), application (application token), a smart contract or other technology.

Token may have a regime of the respective legal concept whose function a Token fulfils, including money, security, claim against another person, right in other property, license and so forth.

The function of token may be derived from protocol, smart contract or applications and determined by the Issuer.

1.2 Tokenization

Tokenization refers to a process of issue of tokens.

1.3 Distributed Ledger

“Distributed Ledger Technology” (DLT) is a database architecture that enables members (nodes) in a network to securely keep, validate, share, replicate and synchronize records in a distributed way among the members of a network.

“Distributed Ledger” (DL) means the records aggregated and stored via DLT. DL has protocol which determines technical functioning of DL including the statuses of network members (protocol statuses).

1.4 Blockchain

Blockchain is a type of distributed ledger that maintains a continuously-growing records of digital transactions which are aggregated into, and secured by means of cryptography, as Blocks.

“Block” means an encrypted record of transactions generated by means of computing capacities that might be added to Blockchain after validation.

2. Project goal

A. The purpose of Tokenization can be of economic or social nature.

Tokenization with economic purpose is defined by the projects that are fundraising to pursue a commercial goal which is aimed at generating profits for a company or project to build solutions, teams and products with the objective to create revenue and generate economic value and become self-sustainable.

Tokenization with social purpose is defined by fundraising efforts by project teams for charity, social good, sustainability goals or similar reasons and are not pursuing any commercial goals or profits.

B. Tokenization may become a primary funding mechanism for newly established companies in the technology business or serve as mechanism for raising capital for already existing businesses.

Whichever the pursued target – economic or social nature –, the fundraising itself should never be the purpose and objective of a team but be considered a means to

achieve the project goal. If Tokenization serves solely as funding mechanism, i.e. acting as a financial instrument to access capital markets (shares, equity, options, participation, etc.) and not as the start to a blockchain-based solution or product with a token fulfilling certain functions, this should be clearly stated in the whitepaper.

Funds raised should be limited to what the issuer actually requires for development of the product or business. This should be confirmed by the relevant business plan and financial model.

Existing assets or services may also be tokenized without the objective to access capital, but to enable their fluidity and liquidity.

2. Investor protection

Token issuers shall conduct the token issuance and sale in alignment with investors' interest.

To ensure consideration of investors' interests, the purchasers of tokens must be able to understand the characteristics and functionality of the tokens they are buying, the challenges and risks of development and their investment, the benefits of using the network of the issuer and how raised funds will be allocated and used by the project team.

There are two phases of a Tokenization that require information disclosure to the investors:

Phase 1: Tokenization

This phase includes both the token pre-sale event that is concluded before the official tokenization campaign goes live (pre-sale activities) and the official campaign itself.

The following information should be disclosed in a whitepaper during this phase:

- The legal name of the entity conducting the token sale and its legal structure;
- A detailed technical description of the proposed project and implementation, with reasoning for technology of choice, including logical selection of such;
- A detailed description of the token sale process, including sale address accessibility, handling, process of return of funds to investors under given conditions;
- Characteristics and functionality of the tokens, including when and how the functionality (access, contribution or others) can be applied by the investors;
- Rights, responsibilities and options transferred to the investor through acquisition of the token, how they are documented (with reference to specific participation and issuing conditions) and how they are invoked;
- Description of the protocol, the network (including standard of token issue) and code base, as well as open source access to the code (if applicable);
- Business plan: sound proof for market needs and potential client and investor base (including restrictions that may arise in this respect) for the solution to

be developed, business case (including proposed financial model) and business case, including competitor analysis and risk evaluation for the project, cyber security risks, regulatory, tax, market and counterparty risks;

- A detailed development roadmap with milestones and areas of responsibility;
- Reasoning (based on the roadmap) and a detailed description of the total token supply and distribution (with indication of percentage of tokens allocated to different project needs, such as project development, bounty, project team etc. as well as percentage of tokens that will be reserved), including premium or discount ratio, minimum and maximum amounts of sales, scheduled and potential lock-up period (if any);
- Estimates of time and costs for each stage of the project, use of funds; detailed allocation of funds and tokens to team members, investors and advisors;
- Name and background of team members;
- Remuneration paid to key members of the development team and advisors;
- Information about independent security audit(s) and a bug bounty program that are put in place – and if none is provided for, disclosure of such absence;
- Information about third party legal, tax and accounting advisor and summary of conclusions on legal classification and accounting principles applicable to the token sale in the main relevant jurisdictions for the project;
- Information on alignment of the project with relevant regulations and laws;
- Clear description of pricing mechanism (denomination in one currency), including risk factors that may have big impact on the price of tokens;
- Security of the tokens;
- Information about market making strategies, burning of tokens and additional issue policies;
- Know-your-customer (KYC) and anti-money laundering (AML) process;
- Measures to prevent insider trading and market manipulation; and
- Information on token exchange, including how and where the token can be acquired or sold after the issue, possibility to use the tokens to buy goods or services or make payments to third parties and possibility of buy-back option and corresponding conditions.

Phase 2: Post-Tokenization

This phase refers to set of actions to be followed by the project team on disclosure and transparency towards investors after the pre- and main Tokenization campaign is over.

The following information should be disclosed on the web-page and / or similar means of communication of information of the Tokenization project after Tokenization campaign is over:

- Public key (address) of the wallet used for attracting funds during tokenization (if any) to display investor and project team transactions;
- Number of tokens sold in the private sale (including disclosure of conditions of the private sale) and that in public sale;
- Number of tokens retained by the issuer and the related entities;

- Periodical disclosure (minimum on quarterly basis) of development of the project compared to the roadmap; and
- Timely disclosure of occurring of important facts that may affect token price significantly.

3. Risk Management

There are four basic types of risks that may arise as a result of selecting Tokenization as fundraising mechanism:

- Operational risks, including cyber security risks;
- Financial risks;
- Reputational risks; and
- Regulatory risks.

In addition to these, there might be other risks that are specific to each project.

Token issuers shall adapt proper corporate governance as well as risk management policies and procedures which can be based on the following mechanisms:

- Internal risk assessment matrix;
- Risk mitigation plan; and
- Qualified personnel dedicated to risk management.

The following actions may be undertaken to control and mitigate mentioned risks:

Operational risk management should be related to the storage methods and security of tokens (exchange hot wallet, portable cold storage, or third party custodian).

Financial risk management should consist in diversification of a certain portion of assets into liquid token holdings to have consistent beta exposure to the market. Also a portion of the raised funds can be converted into fiat currency to ensure continued operation.

Regulatory risk management should consist in compliance with all applicable laws and requirements, specifically with financial markets regulation and AML / KYC legislation.

Token issuers shall establish their own AML / KYC policies in line with applicable legislation, designate a responsible officer and monitor compliance with such policies on a constant basis.

In addition, token issuers shall engage in communications with regulators in relevant jurisdictions, as well as to monitor legislation that may affect the project and its investors in jurisdictions in which it operates.

4. Record keeping

Token issuers shall ensure that information about all the transactions and management decisions is traceable, properly documented, archived and stored in accordance with applicable legislation and business practices.

This should include detailed records of a token generation event, full AML / KYC information on private and public sale investors, fund movement details through wallet transfers and documentary evidence of project expenses.

5. Market practice

Token issuers shall adapt effective measures to prevent insider trading and market manipulation activities.

Information normally refers to facts including firm intentions, as yet unrealised plans and prospects. Facts external to the token issuer, such as knowledge of a financial analysis awaiting publication, a large customer order, a licence or authorisation that is to be granted or refused, are also normally deemed to constitute information. Rumours and speculation do not constitute information.

Information must be sufficiently clear and certain that it may provide a basis for anticipating the future trend in the price of the token.

Information is deemed to be confidential if it is not generally available and is instead only available to a restricted group of people. Information is deemed to be in the public domain if unconnected third parties are able to obtain it from generally accessible sources.

The question of whether or not information is price-sensitive, i.e. capable of substantially influencing the market price of the tokens, is to be decided on a case-by-case basis with reference to whether or not the information is capable of influencing the investment behaviour of a reasonable investor who is familiar with the market. In principle, substantiality is assessed according to the market situation prior to the information being known.

Token issuers shall not take advantage of the expected market reaction of market participants and of token prices in the knowledge of insider information.

6. Due diligence

Due diligence processes conducted by the project team are key to successful business models and companies using blockchain technologies and tokens. Long-term stability and growth of such projects and the industry as a whole ensures growing trust and capital flow from investors and in turn an increase in global economic growth and wealth. The TSA suggests the following diligence guidelines to be followed:

- Ensure a qualified and professional project team with sufficient competencies and experience in the relevant business areas in order to achieve the project goals. Make sure that the remuneration of the project team is directly connected with achieving the milestones set for the project;

- Make use of an open and transparent blockchain protocol where possible (privacy and data protection laws apply). Avoid the use of unintelligible blockchains, or technology stacks which allow or even foster centralization of voting power, of transaction validation, or any other form of centralization of determining power over distributed tokens;
- Where possible, commit to using well-known token standards;
- Commit to undertake at least one independent security audit and a thorough analysis of the code and potential bugs before the launch of a Tokenization campaign;
- Have an independent expert review the whitepaper;
- Engage legal and tax advisor in every jurisdiction that is conducting the token sale;
- Establish prudent rules of solicitation;
- Establish multiple methods of communication with regulators and token purchasers and provide options for automatic refund of contributed amounts before Tokenization is over;
- Ensure measures for prevention and combating scam websites;
- Engage crypto custodians to safe keep proceeds raised and tokens reserved; and
- Establish relationships with financial intermediaries (banks, brokers, exchanges and others) services of which will be required in order to make the project fully operational and agree on basic requirements and terms of cooperation.

IV. Adherence to the Standards

All members of the Association that request to obtain the TSA Qualified Token Issuer title must comply with the Standards set in the present document.

In relation to the members that have obtained TSA Qualified Token Issuer title, the Board of the Association and other members will periodically assess whether any violations of the Standards have occurred and, if so, which remediation or disciplinary measures are appropriate. Such measures may include financial penalties or revocation of title and termination of membership in the Association.