

DIGITAL ASSET & TOKENIZATION IN ISLAMIC CAPITAL MARKET: SOME SHARIAH INSIGHTS

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Global Trends in Digital Asset Adoption

Rising Digital Asset Adoption

Digital assets are increasingly accepted worldwide, transforming how financial transactions occur across markets.

Technological Advancements

Innovations in blockchain & fintech are enabling integration of digital assets into financial systems.

Regulatory Interest

Governments & regulators are actively engaging to create frameworks to ensure safe digital asset use.



Regulatory Focus on Digitalisation in Malaysia



- Digitalization & fintech have been the buzz words in recent years in Malaysian Financial landscape
- **Advance digitalisation** is one of the **5 Strategic Thrusts** in BNM Financial Sector Blueprint 2022-2026
- **Embracing the Digital Age** is one of the **3 Regulatory Thrusts** in SC Capital Market Masterplan 3 2021-2025
- Malaysia was among the first few countries in the region that has introduced a specific regulatory framework to facilitate the trading & offering of digital assets.
 - ✓ 15th January 2019: Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019 came into force, prescribing digital assets that fulfil specific conditions as securities.
 - ✓ 31 January 2019: Release of amended Guidelines on Recognised Markets to include a new chapter for Digital Asset Exchanges (DAX)
 - ✓ 15 January 2020: Release of Guidelines on Digital Assets that outline the framework for fundraising through digital token offering in Malaysia
 - ✓ July 2020: SAC of SC Resolution on Digital Assets

Some Basic Definitions

Digital Assets

A digital asset exists in a digital format & has identifiable value. This includes a wide range of items, from traditional digital files like photos & documents to more complex assets like cryptocurrencies & non-fungible tokens (ref: Investopedia)

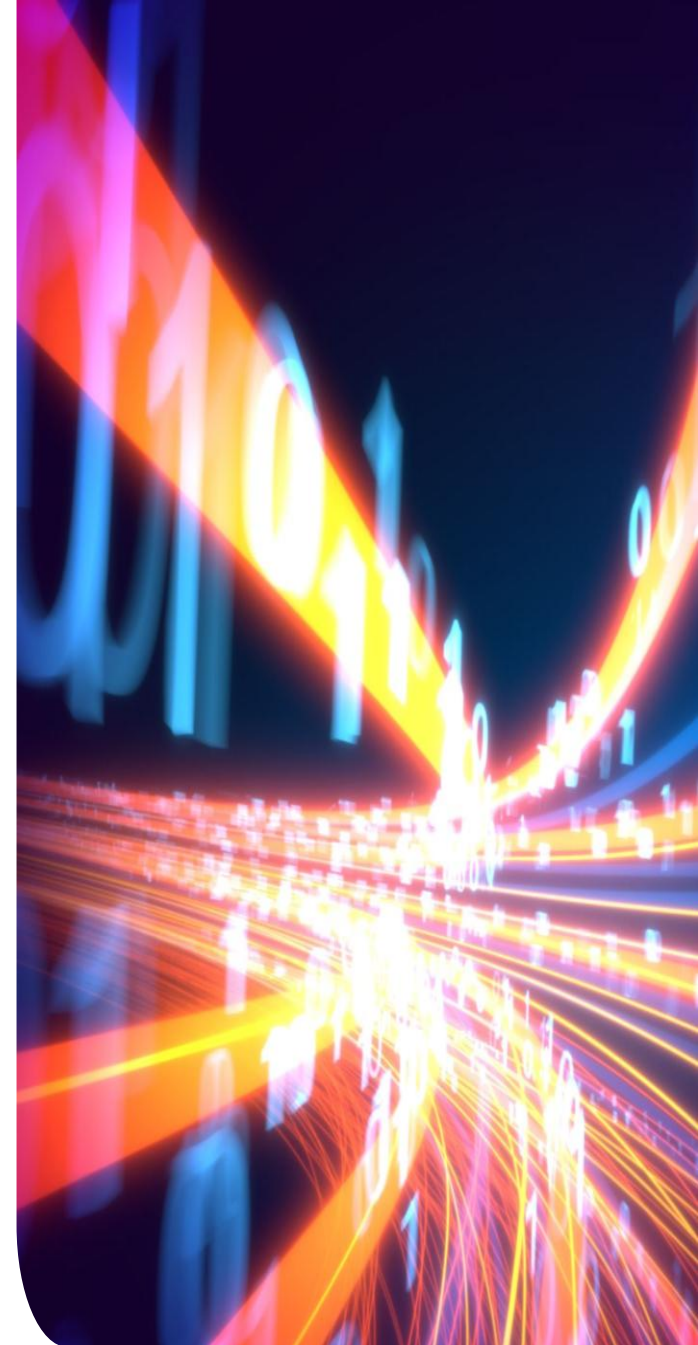
Digital tokens & digital currencies are forms of digital assets, but they differ in their structure, use cases, and underlying technology.

Digital Currency

This is a broad term that encompasses all forms of money in digital format. It includes both centralized forms (like e-money issued by banks) & decentralized forms (like cryptocurrencies).

Digital Tokens

Tokens are a specific type of digital asset that are built on existing blockchain platforms. They can represent various assets or utilities & are often used within specific applications or ecosystems. E.g. tokens for voting rights, access to services, or as a medium of exchange within a particular platform.



Definition & Types of Digital Assets regulated by SC

Digital assets regulated by the SC Malaysia are those defined as securities & consist of:

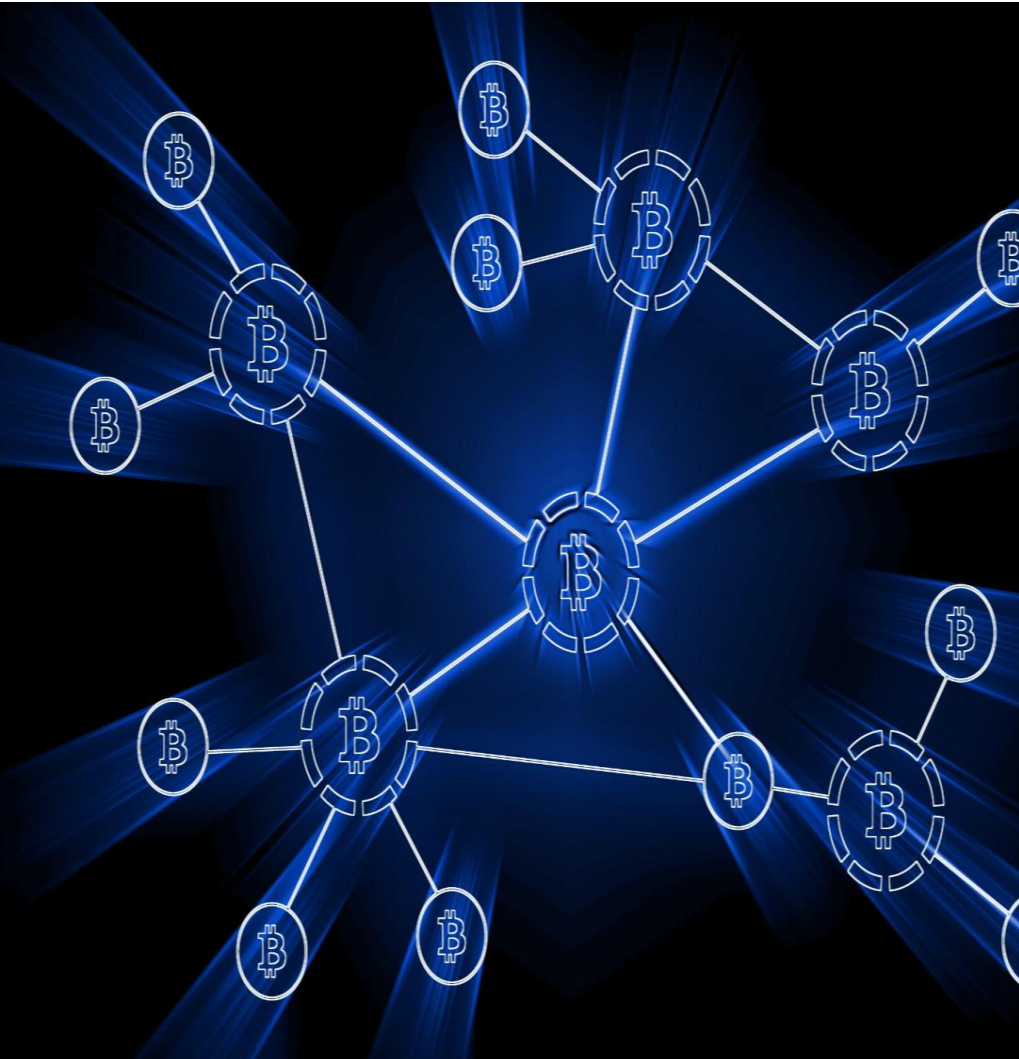
- i. **“digital currency”*** means a digital representation of value which is recorded on a distributed digital ledger whether cryptographically-secured or otherwise, that functions as a medium of exchange and is interchangeable with any money, including through the crediting or debiting of an account; and
- ii. **“digital token”** means a digital representation which is recorded on a distributed digital ledger whether cryptographically-secured or otherwise.

*Refers to a digital currency that is approved by the SC for trading on *Digital Asset Exchange (DAX)*

Note: The definition & scope of digital currency & digital token which were defined as securities are as prescribed under the Capital Markets & Services (Prescription of Securities) (Digital Currency & Digital Token) Order 2019. See: <https://www.sc.com.my/api/documentms/download.ashx?id=8c8bc467-c750-466e-9a86-98c12fec4a77>



Key Shariah Issues in Digital Assets



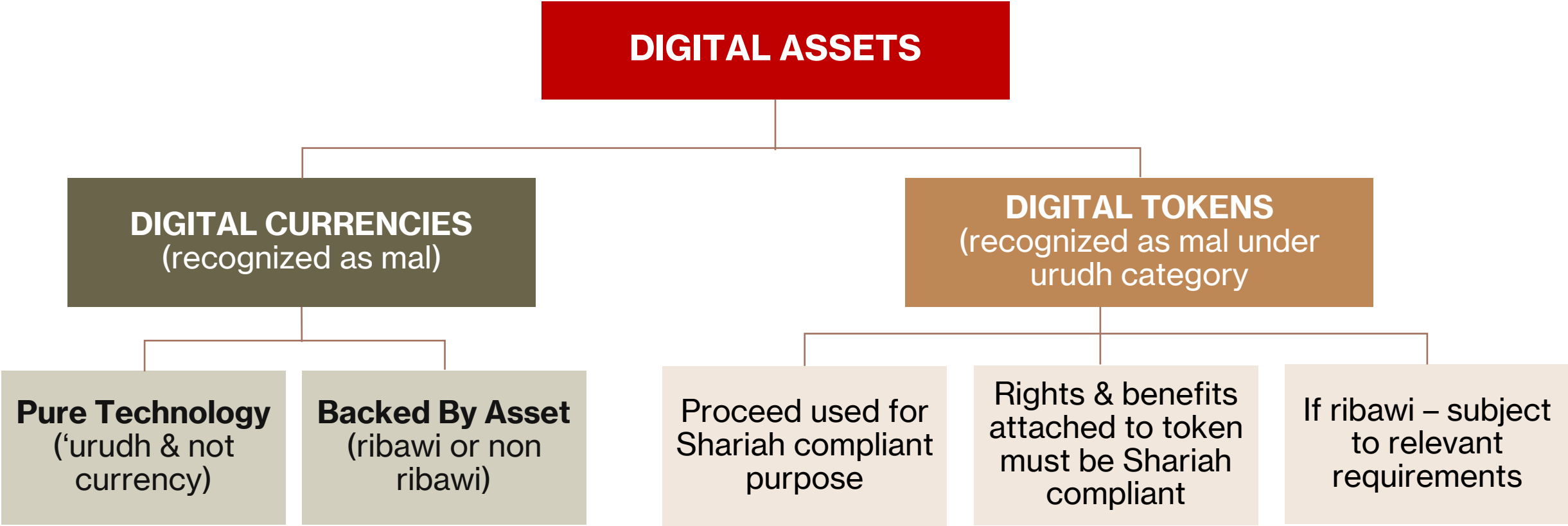
Since there are Digital Assets which are categorised as capital market instruments, the SAC of SC had discussed the following issues from Shariah perspective:

- (i) Whether Digital Assets can be recognised as *mal* (asset) from Shariah perspective?;
- (ii) Whether Digital Assets can be classified as currency or *`urudh* (goods)?; and
- (iii) How to determine the Shariah status of a digital token?

According to the majority of Islamic scholars, *mal* refers to something that has value, can be traded and shall be subject to compensation for anyone who damage it. al-Suyuti, *al-Asybah wa al-Naza'ir*, 1983, p. 409.

Ibn Qudamah defines *`urudh* as *mal* other than currency such as plants, animals, lands and others. Meanwhile, for al-Bujairimi, anything that is exchanged with currency, it is considered as *`urudh*. Ibn Qudamah, *al-Mughni*, v. 4, p. 249, al-Bujairimi, *al-Bujairimi `ala al-Khatib*, v. 3, p. 55.

SAC of SC Resolution on Digital Assets

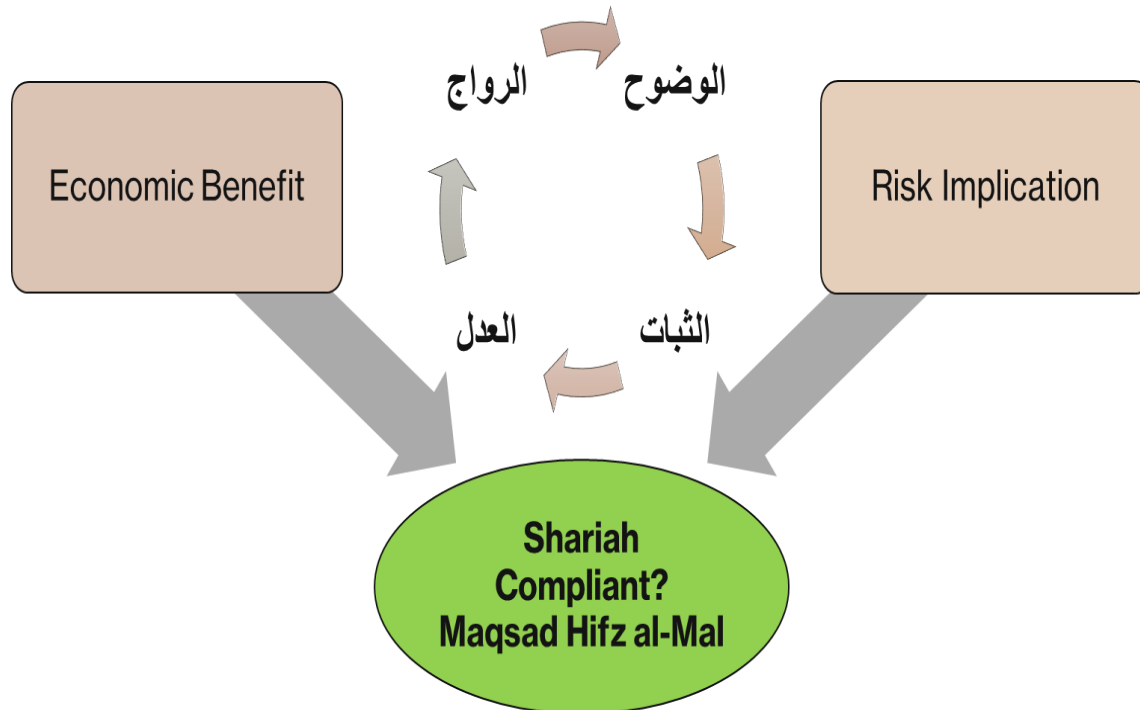




Deeper Shariah Insights

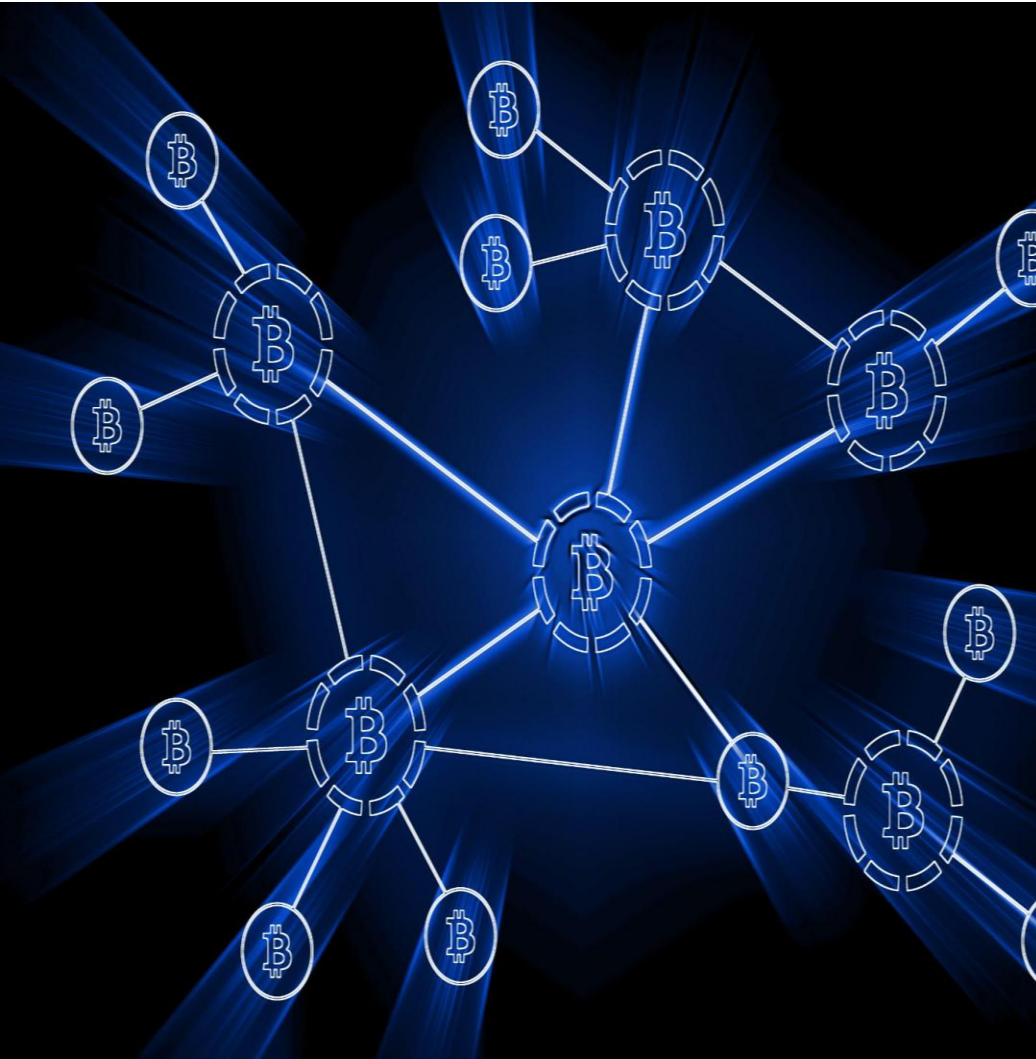
What is the value that we are creating from Digital Assets?

Is this value aligned to Maqasid al-Shariah & other Islamic principles?



- ✓ Digital Currency based on technology without any underlying vs Digital Currency backed by asset(s)
- ✓ Tokenisation of traditional assets vs tokenisation of non-traditional assets (e.g. NFTs, etc)
- ✓ Common understanding of riba, gharar & maysir vs hidden features/behaviour that may create impressions of some of the prohibited elements

Tokenisation & Its Benefits



Definition of Tokenisation

Tokenization converts asset rights into digital tokens on a secure blockchain platform.

Benefits of Tokenization

It enhances liquidity, transparency, and accessibility for asset holders and investors.

Tokenization refers to the process of creating a digital representation of real-world assets on a blockchain, enabling fractional ownership & increased accessibility to financial markets – represents a transformative shift in how assets are owned, traded & accessed, with the potential to create a more inclusive & efficient financial ecosystem.

Benefits

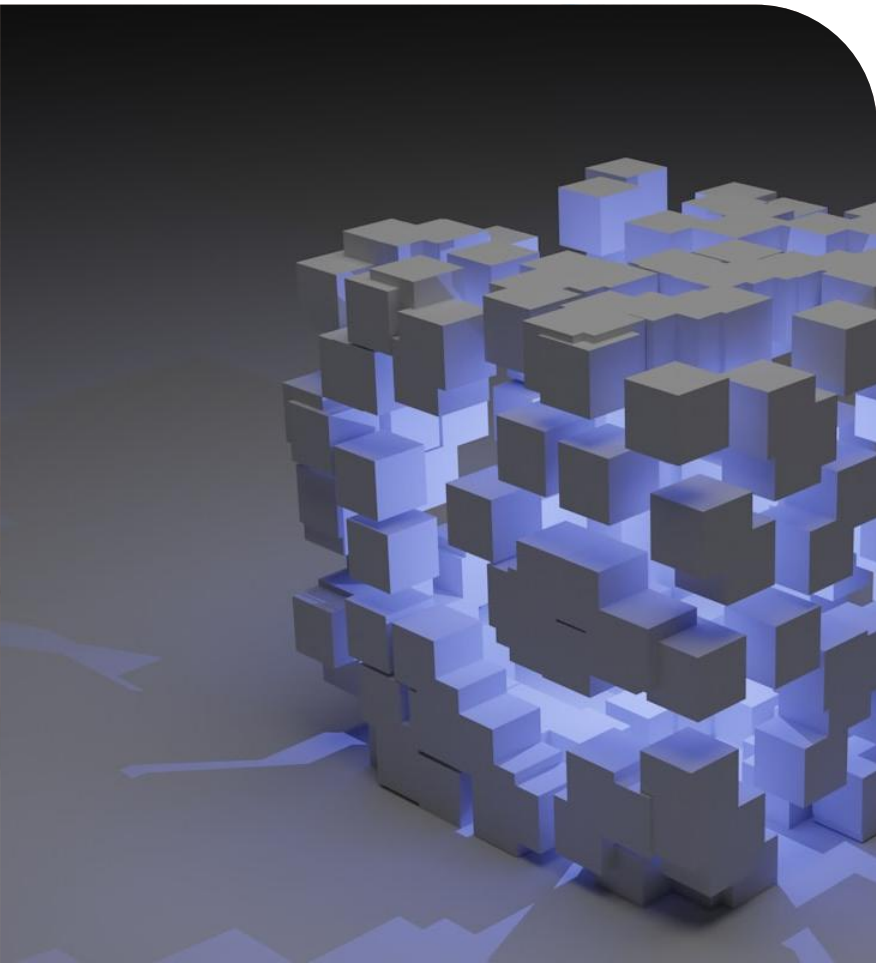
Increased
Accessibility

Enhanced
Liquidity

Cost Efficiency

Transparency &
Security

Applications of Tokenisation



Real Estate: Investors can purchase fractions of properties, making real estate investment more accessible to a broader audience.



Digital Securities: Tokenization allows for the creation of digital securities that represent ownership in traditional assets, such as stocks & sukuk.



Art and Collectibles: High-value art pieces can be tokenized, allowing multiple investors to own a share of the artwork.

Regulatory Considerations

As tokenization grows, regulatory bodies are examining its implications for market integrity & investor protection. Regulations are being developed to address the unique challenges posed by tokenized assets, ensuring that they are integrated into the existing financial framework safely & effectively.

(IOSCO)

Regulatory & Risk Management Issues



Navigating Regulatory Variations

Different jurisdictions have varying regulations & Shariah treatments which complicate digital asset regulation & governance globally.

Risk Assessment

Effective risk assessment is crucial to identify and mitigate potential threats in digital asset investments.

Transparency in Investments

Transparency builds trust by providing clear information about digital asset operations and compliance.

Investor Protection Mechanisms

Mechanisms to protect investors from fraud and market volatility are essential to maintain confidence.

Safeguards

Shariah Scholars

Shariah scholars to provide guidance ensuring compliance with Islamic principles as well as alignment with Maqasid considerations

Financial Intermediaries/platform providers

Financial intermediaries/platform providers to play a pivotal role in ensuring soundness & integrity of digital asset offerings and investments

Investors

Investors need to exercise prudence & sound judgement in evaluating complex financial products and seek proper advice whenever appropriate, especially in terms of Shariah compliance and investor protection

Regulatory Bodies

Regulatory bodies to set standards & regulatory safeguards to ensure transparency, compliance & investor protection in digital asset offerings and investments



Conclusion

- **Transformative Potential**
 - Digital assets and tokenization can transform Islamic capital markets by introducing innovative financial instruments.
- **Shariah Compliance**
 - Aligning new technologies with Shariah principles is essential to maintain credibility & integrity.
- **Value Creation**
 - Genuine value creation that is aligned to real economic productivity and well-being will ensure stability, equitable growth and alignment with Maqasid Shariah.

