

CRYPTOCURRENCY > STRATEGY & EDUCATION

Cryptocurrency Security Token: Definition, Forms, Investing In

By CHRISTINA MAJASKI Updated May 27, 2022Reviewed by SOMER ANDERSON

What Is a Security Token?

Because blockchain technology emerged from the field of data science, many of the terms used in cryptocurrency and tokens are similar to those used in those fields. The term "token" is one of them. A token, in data science, is a value—like a randomly-generated number—assigned to sensitive data to mask the original information. So in a blockchain, a token is a number assigned to data stored within the blockchain. Giving an asset a token is called "tokenization."

As an investment asset, a security token is a digital asset that represents ownership or other rights and transfers value from an asset or bundle of assets to a token. In plain language, security tokens are the digital form of traditional investments like stocks, bonds, or other securitized assets. For example, a company that wishes to raise funds for an expansionary project can decide to issue fractionalized ownership of their company through a digital token instead of issuing stock. It could then offer this token to investors on an exchange that allows digital security tokens.

Learn more about security tokens, how they work and are regulated, and how they are different from other digital assets.

KEY TAKEAWAYS

- Security tokens are digital assets that represent transferred ownership rights or asset value to a blockchain token.
- A security token is created using tokenization, where the investment criteria are selected. The information is entered into the blockchain,

institutions are working to develop and offer them.

- The Securities and Exchange Commission must approve security tokens.

Important: Tokens are viewed as securities by regulators when they meet the criteria set by the Howey test; that is, there is an investment of money, a common enterprise, and a reasonable expectation of profit through effort. ^[1]

Understanding Security Tokens

Understanding tokenization is crucial for understanding security tokens.

Anything can be tokenized: you can create a token that signifies the ownership and registration of a car. The car's vehicle identification number (VIN) could be tokenized along with the owner's name, address, and other information required by a state to register a vehicle. The state's motor vehicle department would use a blockchain interface program to enter the information into their blockchain, which would generate a vehicle registration and ownership token.

A security token is created similarly—a company could input what the token represents, and the token would be generated. The company would then offer this token on an exchange or other appropriate investment platform for investors—ownership would then be recorded on the blockchain.

The idea behind tokenizing ownership of a company or an asset isn't necessarily new. For example, companies used to give paper stock certificates to investors that purchased stocks. The paper certificate was a token that represented ownership or other rights granted to the investor. A digital security token is no different, except it is digital and has gone through a blockchain tokenization process.

FAST FACT

Most security token platforms use the Ethereum ERC 2.0 or Tezos' FA1.2 standards for generating tokens.

along with its value. On the other hand, it might only be a number your wallet keeps track of. The wallet could display your holdings, value, and any dividend distributions. Your wallet might also provide quick access to a prospectus or annual reports.

How are Security Tokens Different From Cryptocurrencies?

Security tokens and cryptocurrencies are nearly identical. They are created by and stored on a blockchain. They are both tokens, but the crucial difference lies in their purpose, intended use, and actual use. A cryptocurrency is designed to be used as currency, money, or payment method. A security token is intended to be used the same way a stock, bond, certificate, or other investment asset is used.

Many cryptocurrencies have been introduced which were not intended to be used as investment instruments. For example, investors and traders noticed that they could reap significant returns from Bitcoin when it was listed on cryptocurrency exchanges. As a result, investors treat Bitcoin as a security token even though it was not designed as one.

Important: The Securities and Exchange Commission does not view Bitcoin and Ethereum as securities. [\[1\]](#)

Ethereum's native token, ether, was developed to be used to pay transaction fees within the Ethereum network. In that respect, ether is a cryptocurrency. However, because it is being traded on exchanges and held for its increasing value, investors treat it as a security token.

However, because BTC and ETH are not designed to be used as security tokens, and there is no expectation of profits from the developers, they do not currently meet the criteria to be considered securities by the SEC.

What Is a Security Token?

A security token represents [rights of ownership](#), transfer of value, or promise of returns that are tokenized on a blockchain. It is intended to be treated as an investment instrument.

within the Ethereum Virtual Machine to pay transaction fees. Owners will also be able to "stake" their ether (ETH) for a chance to become a network validator and earn more (ETH) when "the Merge" happens.

Can I Invest in Security Tokens?

Security tokens are not yet available for retail investors on public stock or cryptocurrency exchanges.

ARTICLE SOURCES ▼

Related Terms

What Is Total Value Locked in Cryptocurrency?

Total value locked (TVL) is a metric used in the crypto sector to determine the total U.S. dollar value of digital assets locked, or staked, on a particular blockchain or dApp. [more](#)

Digital Asset: Meaning, Types, and Importance

A digital asset is anything in digital form with value, ownership, and usage rights. Learn more about digital assets, how they evolved, and what they mean. [more](#)

Is Crypto a Commodity? What It Means, Examples

A crypto commodity is a digital representation of a commodity, utility, or contract on a blockchain network through exclusive tokens. [more](#)

Cryptocurrency Explained With Pros and Cons for Investment

A cryptocurrency is a digital or virtual currency that uses cryptography and is difficult to counterfeit. [more](#)

Howey Test Definition: What It Means and Implications for Cryptocurrency

The Howey Test determines which transactions qualify as an "investment contract" and would therefore be subject to U.S. securities laws. [more](#)

How to Buy Baby Doge Coin