

HONG KONG CRYPTO REGULATION

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GOING FORWARD - FATF REQUIREMENTS

Areas for the attention of Hong Kong's regulators:

- 01** | crypto exchanges which only trade cryptocurrencies which are not securities or futures contracts are unregulated;
- 02** | proposed FSTB licensing regime is narrower than the FATF Recommendations;



RECENT DEVELOPMENTS - PAYPAL

OCT 2020

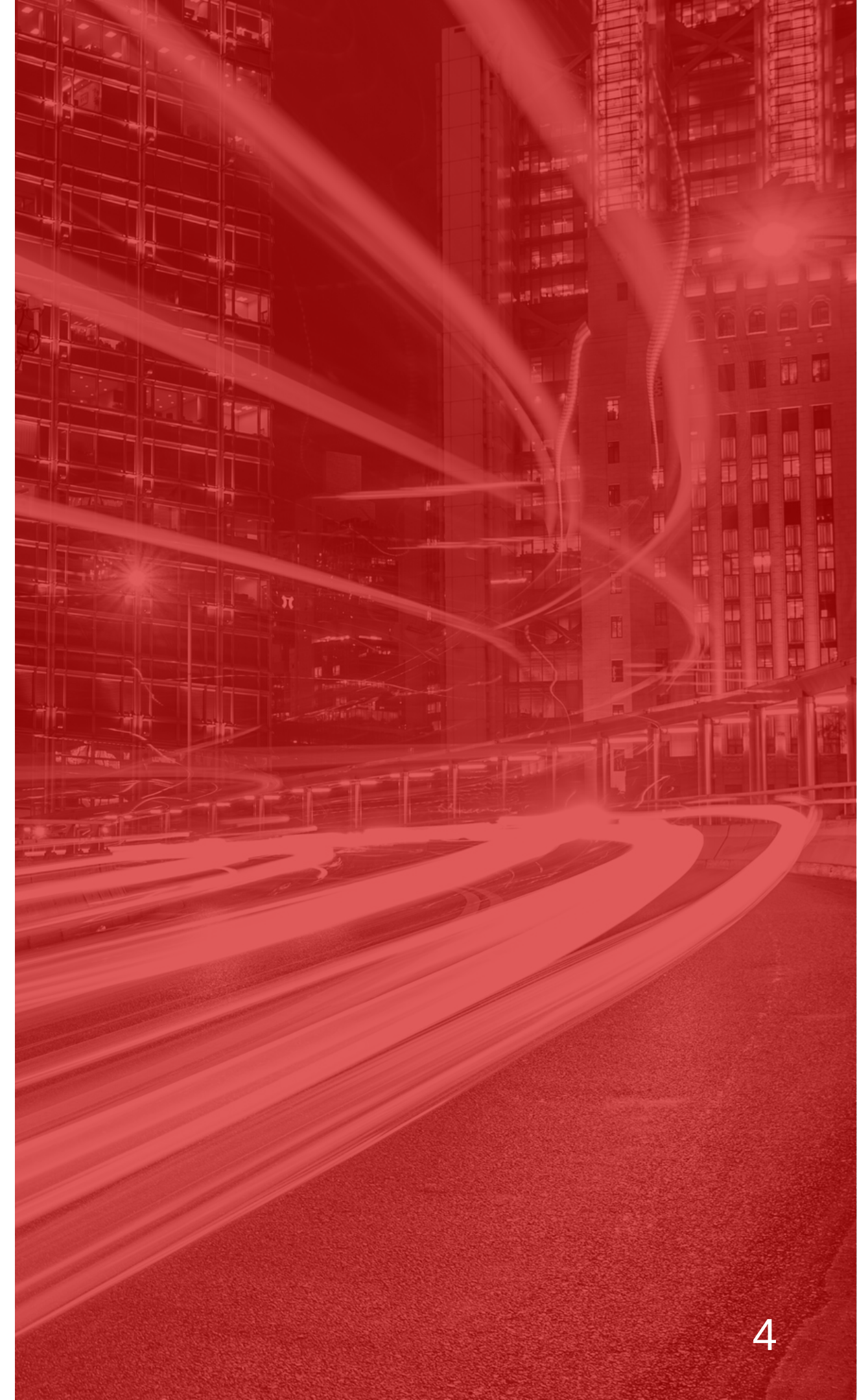
PayPal announces the roll out of crypto features for US users and the approval of its conditional Bitlicense

2021 onwards

PayPal users will be able to pay for goods in crypto in transactions with 26m sellers around the world

PAYPAL - WHAT DOES IT MEAN FOR HONG KONG?

- **in-person trades**
- **Bitcoin ATMs**
- **Bitcoin exchanges**
- **Hong Kong exchanges**
- **OTC exchanges**





COLLABORATION ON THE DIGITAL YUAN

JAN 2020

HKMA published findings of research into a digital currency project in conjunction with the Bank of Thailand

SEP 2020

HKMA announced that Consensys will lead Phase 2

COMPARISON OF HK AND MAINLAND DIGITAL CURRENCY PROJECTS

Mainland

- 01** tailored to retail market
- 02** developed under the control of the PBoC
- 03** based on a government-run, centralised network

Hong Kong

- 01** restricted to wholesale institutional use
- 02** developed in collaboration with the private sector
- 03** developed using distributed ledger technology

APPROACHES TO VIRTUAL ASSET REGULATION

- 1| application of existing regulation
- 2| retrofitted regulation
- 3| bespoke regulation
- 4| bespoke regulatory regimes



CHINA - REGULATION



SEP 2017

PBoC banned ICOs

DEC 2018

ban extended to security token offerings and airdrops

FEB 2019

restrictions imposed on blockchain information service providers

CHINA'S DIGITAL CURRENCY PROJECT

DCEP (or "digital yuan") - a CBDC controlled and issued by the PBoC



currently on trial in 4 major cities

- Shenzhen
- Suzhou
- Chengdu
- Xiong'an

JAPAN - REGULATION OF CRYPTO EXCHANGES

APR 2017

PSA revised and crypto recognised as a legal payment method

MAY 2020

amendments to the Payment Services Act took effect

MAR 2020

23 approved crypto exchanges

MAY 2020

amendments to the FIEA

US - REGULATION

SEC - may regulate as securities

CFTC - classifies as commodities

FinCEN - treats them as currency



US - ICOs



"an investment contract is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others"

01 | purchasers of DAO had invested with a reasonable expectation that they would receive a return

02 | promotional materials informed investors that they would share in the profits of the projects funded by their investment

03 | token holders could monetise their investment by reselling DAO tokens in the secondary market

04 | profits were "derived from the entrepreneurial or managerial efforts of others"

US - DAO AND THE HOWEY TEST





US - UTILITY TOKENS

- **statements by SEC officials - "all ICOs are securities offerings" (except Bitcoin and Ether)**
- **cryptocurrencies can evolve from being securities to non-securities once the network on which they function is sufficiently decentralised such that purchasers no longer expect any person or group to carry out essential managerial or entrepreneurial efforts as required by the Howey Test**
- **key feature of a utility token - typically provide a right of access to a specific product or service provided or to be provided by a DLT platform**
- **utility tokens may be securities if marketed as investment products**

- **DEC 2020 - SEC brought regulatory action against Ripple and two senior executives for allegedly conducting a US\$1.3 billion unregistered securities offering**
- **SEC complaint alleges that XRP is an "investment contract" within the Howey Test**
- **Ripple disputes the allegation on the grounds that:**
 - (1) XRP is a currency similar to Bitcoin and Ether (which are not securities);**
 - (2) XRP has a fully functioning ecosystem and a real use case as a bridge currency that does not rely on Ripple's efforts for its functionality or price**

US - SEC ACTION AGAINST RIPPLE

TELEGRAM



- there was a common enterprise
- a reasonable initial purchaser would have purchased Grams with investment intent and an expectation of profit
- the expectation was based on the essential entrepreneurial and managerial efforts of Telegram
- Telegram failed to demonstrate that it was exempt from the registration requirements under Regulation D

KIK



- KIN tokens were offered in both a pre-sale and a public sale
- the Court concluded that both transactions were integrated and constituted an unregistered securities offering

US - INVESTMENT VEHICLES INVESTING IN DIGITAL ASSET SECURITIES

- SEC Nov 2018 - funds investing in crypto assets that are securities must be registered under the Investment Company Act and fund managers must observe the registration, regulatory and fiduciary obligations under the Investment Advisers Act



US - TRADING DIGITAL ASSET SECURITIES

- a trading platform which offers trading of crypto assets which are "securities" and operates as an "exchange" must be registered with the SEC as a national securities exchange or be exempt from registration
- an exemption is available for an alternative trading system which is registered with the SEC as a broker-dealer and becomes a member of a self-regulatory organisation such as the FINRA
- crypto trading platforms are also regulated by other agencies at both federal and state levels

US - STATEMENT ON BROKER- DEALERS

23 DEC 2020 - provides a path for crypto-focused broker-dealers (operating in some circumstances) to operate free from a possible SEC enforcement action on the basis that the broker-dealer deems itself to have obtained and maintained physical possession or control of customer fully paid and excess margin digital asset securities



- **18 DEC 2020 - FinCEN proposed new rules for crypto wallets (now frozen by President Biden pending review)**
- **VASPs would be required to record the name and address of wallet owners in the case of deposits and withdrawals exceeding US\$3,000 where a non-custodial wallet is involved and VASPs would be required to report any deposit or withdrawal greater than US\$10,000 to FinCEN through a CTR**

US - CRYPTO WALLETS

A hand is holding a physical Bitcoin coin in the foreground. The coin features the Bitcoin logo and the text 'BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM' and 'DECENTRALIZED • FREE TO USE'. In the background, a laptop keyboard is visible. The entire image has a red tint. The text 'MCQs' is overlaid in white, bold, sans-serif font in the center-right area.

MCQs

QUESTION 1

Which of the following is a requirement placed on a holder of a conditional Bitlicense?

- A. Only provide services to professional investors.
- B. Partner with a company holding a full Bitlicense.
- C. Meet the criteria for a full Bitlicense within one year.
- D. Hold a money transmission licence under New York Banking Law.



QUESTION 2

Which of the following is a feature of China's digital yuan (or DCEP)?

- A. Developed in collaboration with the private sector.
- B. Developed using distributed ledger technology (DLT).
- C. Aimed at wholesale institutional use.
- D. Based on a Government-run, centralised network.



QUESTION 3

In respect of Japan's crypto regulation, which of the following statements is FALSE?



- A. Security tokens are considered to be crypto assets regulated under the Payment Services Act.
- B. Activities relating to security tokens are governed by the FIEA.
- C. The FSA licenses and regulates virtual asset exchanges.
- D. None of the above.

QUESTION 4

Which of the following is NOT a requirement of the Howey Test?

A. The offering involves an investment of money.



B. Investors' funds must be pooled.

C. There is a reasonable expectation of profits from the investment.

D. Any profit comes from the entrepreneurial or managerial efforts of others.

QUESTION 5

Which of the following is TRUE with respect to Blockchain Information Service Providers and Blockchain Services in Mainland China?

A. They are prohibited from operating in any circumstances.



B. Specified personal particulars must be provided when registering for a blockchain service.

C. An operating permit is required to operate a blockchain information service.

D. Natural persons are not subject to the regulation of blockchain information providers.

Q&A