

CRYPTO REGULATION IN HONG KONG AND OTHER MAJOR JURISDICTIONS

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CRYPTOCURRENCY REGULATION

Jurisdictional approaches to crypto regulation fall into four broad categories. The first is that adopted by a small number of countries including Saudi Arabia and Afghanistan which have banned cryptocurrencies outright. The second approach is to severely restrict the use of cryptocurrency, for example China which prohibits the trading of cryptocurrencies and their use for payment as well as initial coin offerings (**ICOs**). The third category comprises countries that have created specific regulatory frameworks for cryptocurrencies – for example Japan, Malta and Thailand. However, the regulation that has been introduced relates mainly to imposing licensing requirements on crypto intermediaries – that is the entities that trade or provide other services in relation to cryptocurrencies. Lastly, the final category of jurisdictions - which is the majority - are those like Hong Kong, the US and the UK which regulate cryptocurrencies to the extent they fall within existing categories of regulated financial instruments, such as securities, commodities or e-money. Some of these regulatory authorities have issued guidance classifying cryptocurrencies according to their characteristics and economic purpose (such as the UK Financial Conduct Authority (**FCA**)). This approach has advantages – adopting a “wait and see” approach to cryptocurrency regulation allows this emerging asset class to develop while knee-jerk imposition of regulation risks stifling innovation, as has been seen to some extent in the US. The downside of trying to regulate cryptocurrencies under existing regulatory frameworks is that shoe-horning these very diverse assets into categories of investments created many years ago for traditional investments has led to a lot of uncertainty as to how the regulations apply. There are arguments for a more nuanced approach to regulating cryptocurrencies.

The International Monetary Fund published a report on crypto regulation in December 2019¹ recommending that while cryptocurrencies continue to evolve, regulatory authorities should consider pursuing a “proactive and holistic approach to regulation” based on a comprehensive assessment of the risks. The report outlines the IMF’s view that there is a need for international cooperation in the crypto space and the need for risk-based and proportional regulation.

Part of the difficulty facing regulators is the speed of evolution in cryptocurrencies and their uses which is being driven by factors as diverse as customer preference, regulation, competition, developments in technology, speculation and privacy and security concerns. Bitcoin, the first ever cryptocurrency, was launched in January 2009 as an alternative means of payment and has evolved into a store of value, hedging and speculative investment tool. As those of you who follow Bitcoin prices will know, 2020 was quite a year. The turmoil that hit financial markets in March 2020 delivered one of Bitcoin’s worst months on record, with prices falling to around US\$3,600, which was Bitcoin’s worst month since the crash at the end of 2018.² Prices then recovered and on 16 December 2020, Bitcoin’s price passed US\$20,000 for the first time ever – a surge of more than 400% from the March low

¹ International Monetary Fund. December 2019. “Fintech Notes: Regulation of Crypto Assets – Note/19/3”. Available at: <https://www.imf.org/en/Publications/fintech-notes/Issues/2020/01/09/Regulation-of-Crypto-Assets-48810>

² <https://www.bloomberg.com/news/articles/2020-03-31/bitcoin-s-march-plunge-is-worst-since-the-crypto-bubble-burst>

point.³ On 3 January 2021, Bitcoin reached an all-time high above US\$34,000. Its soaring valuation is being attributed to increasing institutional interest as investors hedge against inflation.⁴ This also comes against a backdrop of US dollar weakness, US China tensions and, of course, COVID-19 leading cryptocurrency advocates to dub Bitcoin the new gold after periods when both rallied in tandem.⁵

There are now approximately 8,164 cryptocurrencies with a total market cap. of over US\$893 billion as at 4 January 2021. These include payment tokens, ICO tokens, stablecoins, security tokens and more. The largest by far is Bitcoin, which with a market cap of over US\$614 billion on 4 January 2021, is now more valuable than many publicly traded companies. 18.59 million Bitcoin were in circulation and 24-hour trading volume was over US\$81.6 billion on 4 January 2021.⁶ Ethereum and Tether ranked second and third with a market capitalisation of US\$116.5 billion and US\$21.3 billion, respectively, on 4 January 2021.⁷

The number of consumers holding cryptocurrencies has also risen significantly with the highest rates of cryptocurrency ownership and use found in Africa, particularly Nigeria and South Africa, Latin America – where Brazil, Colombia and Mexico have crypto adoption rates of between 18 and 20% - and Asia, particularly Vietnam, according to a recent survey by Statista.⁸ The high cost of transferring money cross border has led many offshore workers to turn to cryptocurrency exchanges to send funds back to their families. Currency instability is also driving cryptocurrency adoption in Africa and Latin America. The lowest rates of crypto use are in English-speaking and European countries. The Bitcoin ATM industry has grown since April 2019. 1,200 new Bitcoin ATMs were installed worldwide between January and April 2020, bringing the total number to 7,500,⁹ and as of 1 November 2020, this number had reached 11,497.¹⁰

In a further sign that cryptocurrencies are entering the mainstream, institutional interest in cryptocurrency sky-rocketed in 2020. In July 2020, Fidelity reported that some 36% of institutional investors worldwide own crypto, while 60% were actively looking at crypto investment,¹¹ with Evertas, the world's first cryptoasset insurance company, attributing the increase in institutional interest to an improved regulatory environment, more mainstream fund managers/financial services companies entering the crypto market and increased choice in terms of

³ <https://www.theguardian.com/technology/2020/dec/16/bitcoin-price-hits-all-time-high-of-more-than-20000>

⁴ <https://www.investopedia.com/why-does-bitcoin-keep-going-up-5092683>

⁵ SCMP. 28 July 2020. "Bitcoin rides wave with gold as Covid-19 relief cash unleashed by central banks sparks search for speculative and safe haven assets". <https://www.scmp.com/business/commodities/article/3094992/bitcoin-rides-wave-gold-covid-19-relief-cash-unleashed-central>

⁶ <https://coinmarketcap.com/currencies/bitcoin/>

⁷ Ibid.

⁸ Statista. 19 August 2020. "How common is crypto?". <https://www.statista.com/chart/18345/cryptocurrency-adoption/>

⁹ Company New HQ. 21 April 2020. "Bitcoin ATMs hit 7,500 across the globe amid Covid-19 pandemic". Available at: <https://www.companynewshq.com/coronavirus-news/bitcoin-atms-hit-7500-across-the-globe-amid-covid-19-pandemic-btcmanager/>

¹⁰ <https://www.statista.com/statistics/343127/number-bitcoin-atms/>

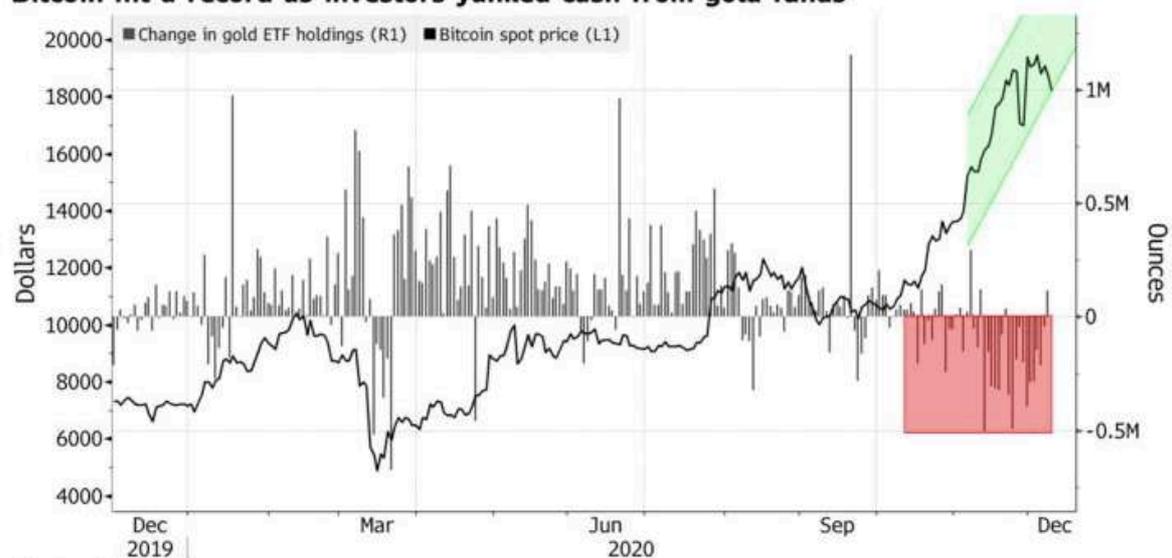
¹¹ Cointelegraph. 18 July 2020. "In Covid-19's wake, the new normal creates crypto opportunities". Available at: <https://cointelegraph.com/news/in-covid-19s-wake-the-new-normal-creates-crypto-opportunities>

cryptoasset focused investment vehicles (to name but a few factors).¹² JPMorgan's Global Markets Strategy report released in October 2020 further suggests that corporate endorsement of cryptocurrency (in particular PayPal) is propagating demand,¹³ and this is supported by the finding that 0.5% of all Bitcoin in circulation is held in the treasuries of publicly traded companies,¹⁴ notably NYSE-listed Square Inc. and NASDAQ-listed Microstrategy. Square Inc. recently allocated 1% of its total assets into Bitcoin and Microstrategy invested US\$425 million in Bitcoin and made it the company's primary treasury reserve asset.¹⁵

As regards the levels of institutional holdings being seen, Coinbase, a US-based cryptoexchange, found that their institutional assets under custody had grown three-fold since April 2020 from US\$6 billion to US\$20 billion as of November 2020,¹⁶ and JP Morgan's calculations indicate that Bitcoin currently accounts for around 0.18% of family office assets (this compares to 3.3% for gold ETFs).¹⁷ JPMorgan has even gone so far as to suggest that gold may suffer for years because of the rise of cryptocurrencies, a trend that is already unfolding. For example, the Grayscale Bitcoin Trust has seen significant inflows (around US\$2 billion) since October 2020, compared to outflows of US\$7 billion for ETFs backed by gold.¹⁸

A New Shiny Plaything

Bitcoin hit a record as investors yanked cash from gold funds



Source: Bloomberg

¹² <https://www.evertas.com/blog/research-reveals-institutional-investors-plan-to-increase-their-allocation-to-cryptoassets>

¹³ <https://news.bitcoin.com/jpmorgan-gold-etfs-bitcoin/>

¹⁴ <https://cointelegraph.com/news/why-institutions-suddenly-give-a-damn-about-bitcoin>

¹⁵ <https://news.bitcoin.com/jpmorgan-gold-etfs-bitcoin/>

¹⁶ <https://www.cryptoglobe.com/latest/2020/11/coinbase-executive-says-institutional-interest-in-cryptocurrency-increased-threefold/>

¹⁷ <https://www.bloomberg.com/news/articles/2020-12-09/jpmorgan-says-gold-will-suffer-for-years-because-of-bitcoin>

¹⁸ <https://www.bloomberg.com/news/articles/2020-12-09/jpmorgan-says-gold-will-suffer-for-years-because-of-bitcoin>

Meanwhile, according to a 9 December 2020 press release, Standard Chartered (in collaboration with Northern Trust) is launching a cryptocurrency custody solution tailored to institutional investors (dubbed “Zodia Custody”), a platform which aims to enable institutions to invest in crypto assets. The platform is expected to launch in London in 2021.¹⁹

We have also seen a number of traditional finance players launching cryptocurrencies. JP Morgan, long a staunch critic of crypto, became the first US bank to launch a cryptocurrency in February 2020 with the launch of its JPM Coin which is pegged to the US dollar. Unlike Bitcoin, the JPM coin operates privately and enables instantaneous international payment transfers between its institutional clients, replacing wire transfers.²⁰ Goldman Sachs is reportedly looking to follow JP Morgan’s lead with the issue of a Goldman coin following the firm’s recent appointment of a new global head of digital assets²¹ who envisages that crypto will cause a radical shakeup of traditional finance within 5 to 10 years, will all financial assets and liabilities on blockchain and everything that today is done physically being done digitally, creating huge efficiencies in debt issues, loan origination, IPOs and securitisation.

Interest in decentralised Finance or **DeFi** also surged in 2020. The opposite of traditional centralised finance or CEFI, DeFi is disrupting traditional market activities such as lending and securities trading by removing the intermediaries (brokers, banks etc.). Instead, transactions are conducted on decentralised open-source networks using smart contracts, cutting costs and improving security.

An example of a DeFi project is MakerDao – a decentralised finance platform that allows borrowers to provide cryptocurrencies as collateral for loans of stable coins called dai that are pegged to the US dollar. According to statistics from DeFi Pulse, over US\$7.7 billion is tied up in the DeFi market, with about US\$4 billion of that having been added in the past few months. Many of the DeFi products facilitate lending and borrowing. Others, such as Uniswap, are automated market makers (**AMMs**) – smart contracts that create a liquidity pool of tokens that are automatically traded by an algorithm rather than an order book.

Stablecoins

Interest in stablecoins has surged during the pandemic making them a key driver of mainstream crypto adoption. A stablecoin is a cryptocurrency designed to be resistant to the price volatility associated with cryptocurrencies such as Bitcoin and Ether. Typically, stablecoins are backed by a reserve of real assets, typically fiat money (e.g. US dollars) or a basket of currencies, bonds, assets like gold or oil, or a mixture of assets. Examples include Tether’s USDT which claims to be fully backed

¹⁹ <https://www.businesswire.com/news/home/20201208006211/en/Standard-Chartered-and-Northern-Trust-Partner-to-Launch-Zodia-a-Cryptocurrency-Custodian-for-Institutional-Investors>

²⁰ Forbes. 17 February 2020. “Stop calling JPMorgan’s JPM Coin a Cryptocurrency because it’s not”. Available at: <https://www.forbes.com/sites/madhvimavadiya/2019/02/17/jp-morgans-cryptocurrency-jpm-coin-is-not-a-cryptocurrency/#6302fdaa21d1>

²¹ Coindesk. 6 August 2020. “Goldman Sachs eyes own token as bank appoints new head of digital assets”. Available at: <https://www.coindesk.com/goldman-sachs-eyes-token-bank-appoints-head-digital-assets>

by US dollars and CNH – Tether’s offshore Chinese yuan backed stablecoin. The value of these stablecoins is locked relative to the reserve currency.

Between March and July 2020, the number of stablecoins doubled to 12 billion, having taken 5 years to reach 6 billion in March 2020.²² US dollar-backed stablecoins in particular saw a boom in this period: the market cap of Binance USD (BUSD), for example, rocketed 176% to US\$188 million in the first 27 days of March 2020.²³ The success of stablecoins in 2020 was boosted by the volatility of traditional asset prices, but how they fare once volatility subsides obviously remains to be seen. 2020 saw a number of developments in stablecoins, with many tapping into the e-commerce space. The end of August 2020 saw the first e-commerce payment using a bank-issued stablecoin – Sygnum Bank’s Digital Swiss Franc (DCHF) – which was used to make a payment on Galaxus, a leading Swiss online retailer.²⁴

JP Morgan’s JPM Coin is another example of a stablecoin. On September 9th 2020, Fnality – a stablecoin project across 13 global banks spearheaded by UBS Group – under development for over 5 years, predicted that it would receive regulatory approval for its “UtilitySettlementCoin” by the second quarter of 2021. The project aims to establish a network featuring tokenised US dollars, Japanese yen, Euros, Canadian dollars and the British pound sterling.

Facebook’s Libra

Facebook’s planned launch of Libra – a global digital currency backed by different currencies and government debt was supported originally by over 20 companies including Visa, Mastercard, ebay and uber. However, it ran into problems with regulators which resulted in some of its biggest backers dropping out. The original proposal was subjected to intense regulatory scrutiny given the possibility of Facebook’s 2.5 billion users adopting the cryptocurrency, threatening regulators’ control over money.²⁵ In an effort to woo regulators, the original plans were scrapped and the planned Libra 2.0 is reportedly planning to launch as early as January 2021. Reportedly a single coin backed one-for-one by the US dollar will launch in early 2021, with other currencies and the composite launching at a later date.²⁶ Launch is however subject to regulatory approval (by the Swiss Financial Market Supervisory Authority (**FINMA**)).

Central Bank Digital Currencies

Central bank digital currencies or CBDCs are another major development which, if they come to fruition, may eliminate the need for stablecoins. The International

²² <https://tokenpost.com/Stablecoins-supply-doubled-since-Marchs-COVID-19-induced-crash-5640>

²³ <https://www.financemagnates.com/cryptocurrency/news/usd-backed-stablecoins-are-booming-amid-the-coronavirus-crisis/>

²⁴ <https://www.insights.sygnum.com/post/coinify-and-galaxus-enable-world-s-first-e-commerce-payment-using-sygnum-bank-dCHF-stablecoin>

²⁵ Reuters. 16 April 2020. “Facebook’s Libra cryptocurrency gets revamp in response to backlash”. <https://www.reuters.com/article/us-facebook-cryptocurrency/facebook-s-libra-cryptocurrency-gets-revamp-in-response-to-backlash-idUSKCN21Y277>

²⁶ <https://www.ft.com/content/cfe4ca11-139a-4d4e-8a65-b3be3a0166be>

Monetary Fund's survey of CBDC research²⁷ published in June 2020 noted that the two primary objectives of central banks exploring the potential issue of a CBDC are: (i) improving financial inclusion; and (ii) maintaining the central bank's relevance in the monetary system. Other objectives include reducing costs and increasing the efficiency of payment systems

China looks set to be the first to launch a digital version of its national currency. The People's Bank of China began trials of China's digital yuan in four major cities in April 2020 and it was recently reported (on 17 December 2020) that Hong Kong's HKMA is in talks to pilot-test China's digital yuan.²⁸ This would be quite significant if it goes ahead as it would be the first time that the digital yuan would be used outside the Mainland and the first application of the digital yuan to cross-border payments.

However, China's digital yuan differs from typical cryptocurrencies in that it is not a separate currency on a decentralised market. Rather the digital yuan will represent the digitalisation of a portion of China's monetary base. The Chinese Government is also reported to be planning a stablecoin backed by a basket of four Asian digital currencies (the Yen, Wong, Yuan and Hong Kong Dollar), to stimulate trade between China, Japan, Korea and Hong Kong and improve cross-border payments.²⁹

Risks Associated with Virtual Assets

Regulators have generally been slow to regulate this space. This is despite a number of concerns related to the risks associated with cryptocurrencies and the general perception of the potential for the distributed ledger technology (**DLT**) underlying cryptocurrencies and cryptocurrencies themselves to deliver significant benefits.

Risks and Benefits

As the IMF report on crypto regulation highlights, regulation needs to be considered in the light of the risks associated with cryptocurrencies which include the following:

- i. Fraud – widespread fraud was a major factor in China imposing a ban on ICOs in September 2017. A statement on the website of the People's Bank of China claimed that some 90% of ICOs conducted were fraudulent and in 2019, China saw a US\$42 billion Bitcoin scandal play out. PlusToken scandal, a scandal that was estimated to be worth more than US\$42 billion. Meanwhile, in the UK, the High Court ordered the closure and winding-up of GPay, a cryptocurrency platform which scammed traders through fake celebrity endorsements. It was reported that GPay had lost US\$1.96 million of investor funds.

²⁷ IMF. June 2020. "IMF Working Paper: A Survey of Research on Retail Central Bank Digital Currency". Available at" <https://www.imf.org/en/Publications/WP/Issues/2020/06/26/A-Survey-of-Research-on-Retail-Central-Bank-Digital-Currency-49517>

²⁸ <https://forkast.news/hong-kong-pilot-test-china-dcep-digital-currency/>

²⁹ <https://internationalfinance.com/chinese-government-proposes-stablecoin-four-asian-countries/>

- ii. Financial crime – the risk of cryptocurrencies being used for money-laundering and terrorist financing. However, the Financial Action Task Force notes in its June 2020 report that use of cryptocurrencies in detected money laundering and terrorist financing cases is relatively small compared to the use of traditional financial services and products.
- iii. Security and security breaches are a key concern – cyber-attacks resulting in crypto exchanges being hacked and cryptocurrencies being stolen are common. Japan, one of the world’s most active markets for cryptocurrency trading, has experienced a series of major hacks resulting in the theft of some US\$580 million worth of cryptocurrencies from the Japan-based Coincheck and Zaif exchanges in 2018. In 2019, more than US\$290 million worth of cryptocurrencies and over half a million customer user logins were stolen from cryptocurrency exchanges worldwide.³⁰
- iv. Risk of misselling and other market-abuse activities such as ‘pump-and-dump’ schemes.
- v. General risk of failure – many ICO issuers are start-ups which have a high failure rate. Consumer protection concerns have focused on the quality of information provided to investors and whether ICOs are suitable investments for retail investors.
- vi. Volatility. For example, Bitcoin’s price reached a then high of US\$19,665 in December 2017 - up 1,824% from its price at the start of 2017 and then crashed to just US\$4,000 by the end of 2018.

On the other hand, cryptocurrencies offer significant benefits. Virtual assets which act as a means of exchange (e.g. Bitcoin) can provide more efficient and cheaper transactions, e.g. in international transfers. As originally conceived by Satoshi, Bitcoin was intended as a “*purely peer-to-peer version of electronic cash [that] would allow online payments to be sent directly from one party to another without going through a financial institution*” (according to Bitcoin’s 2008 whitepaper). Published during the 2008 global financial crisis, Bitcoin’s whitepaper offered up an alternative to the traditional banking sector and financial access for the world’s unbanked populations. The World Bank’s latest (2017) Global Findex Database found that 1.7 billion adults do not have a bank or financial services account – although around 2/3 of them own a mobile phone. Bitcoin was thus envisaged as a means of providing a cheap and fast payment mechanism which could operate cross-border with far greater efficiency than was possible through traditional banks, while eliminating the possible risk of a failure of the financial system. Satoshi did not however foresee that Bitcoin would become a ‘store of value’ or ‘investment’ which people would buy for speculative purposes rather than its use value. The different uses of virtual assets, and the fact that their actual use can be very different from the use intended by their creator, are among the factors making the regulation of virtual assets so challenging. Moreover, when used as a

³⁰ Cointelegraph. 5 January 2020. “Most Significant Hacks of 2019 – New Record of Twelve in One Year”. Available at: <https://cointelegraph.com/news/most-significant-hacks-of-2019-new-record-of-twelve-in-one-year>.

capital-raising method in ICOs, virtual assets can support innovative business models which may have access to traditional fund-raising avenues.

FATF Standards

The most significant regulatory development to date comes from FATF – the setter of international standards on anti-money laundering (**AML**) and counter-terrorist financing (**CTF**). FATF has revised its Recommendations – the global standards on AML and CTF - to explicitly require member countries (which include Hong Kong) to:

- i. Regulate virtual asset service providers or VASPs for AML and CTF purposes;
- ii. License or register VASPs; and
- iii. Subject VASPs to effective systems for monitoring and supervision (revised FATF Recommendation 15).

As of June 2020, 32 regulatory authorities had introduced regulation of VASPs, 3 had prohibited VASPs and 19 had not yet implemented a VASP regulatory regime. As for Hong Kong, the Financial Secretary’s 2020–2021 budget speech stated that the Government would consider extending Hong Kong’s AML/CTF regime to cover virtual asset service providers as required by FATF’s Recommendations.³¹ The FSTB subsequently published a consultation on 3 November 2020 outlining proposals to introduce a new licensing regime for virtual asset exchanges under Hong Kong’s anti-money laundering legislation (the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (the **AMLO**). This new regime would require the licensing of virtual asset exchanges that are not currently required to be licensed under the Securities and Futures Ordinance (the **SFO**) (because they trade virtual assets which are not within the statutory definitions of “securities” or “futures contracts”). Presently, the AMLO only applies to financial institutions (including HKMA-authorized institutions, such as banks, and SFC-licensed corporations) and “designated non-financial businesses and professions” (e.g. lawyers, public accountants, and trust and company service agents). Unless they are licensed by the SFC, crypto currency exchanges and OTC trading desks are not currently subject to the AMLO.

FATF Definitions of Virtual Assets and VASPs

FATF defines a virtual asset as a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes. This definition explicitly excludes digital representations of fiat currencies, securities and other financial assets that are already covered elsewhere in the FATF Recommendations.

Virtual asset service providers or VASPs are defined as any person who is not covered elsewhere in the Recommendations and conducts any of the following activities as a business on behalf of another person:

³¹The 2020-21 Budget. Available at: <https://www.budget.gov.hk/2020/eng/budget13.html>

- i. exchanges virtual assets and fiat currencies;
- ii. exchanges different forms of virtual assets;
- iii. transfers virtual assets (i.e. conducts a transaction that moves a virtual asset from one virtual asset address or account to another);
- iv. provides safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and
- v. participates in and provides financial services related to an issuer's offer and/or sale of a virtual asset.

VASPs thus include cryptocurrency exchanges, providers of certain types of crypto wallets and providers of financial services for ICOs.

June 2019 FATF Updated Guidance

In June 2019, the FATF updated its [Guidance on Virtual Assets and related Service Providers](#)³² and issued an Interpretive Note to Recommendation 15 on New Technologies (**INR. 15**) clarifying how its AML and CFT standards apply to virtual assets.

Application to Countries and regulatory authorities

INR.15 imposes binding measures on member countries for the regulation, supervision and monitoring of virtual asset service providers. In particular, it requires countries to:

- i. apply a risk-based approach to financial activities involving virtual assets and VASPs to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified. Countries should require VASPs to identify, assess, and take effective action to mitigate their money laundering and terrorist financing risks;
- ii. require the licensing or registration of VASPs incorporated or established in their jurisdiction and natural persons who carry on VASP business in their jurisdiction. Jurisdictions may also require the licensing or registration of VASPs which offer products and/or services to customers in, or conduct operations from, their jurisdiction;
- iii. ensure that VASPs are subject to adequate regulation and supervision or monitoring from an AML/CFT point of view and that VASPs effectively implement the relevant FATF Recommendations. VASPs should also be subject to effective systems for monitoring and ensuring their compliance with national AML/CTF requirements and should be supervised by a competent authority;
- iv. apply all FATF preventative measures, including (without limitation) customer due diligence, record keeping, suspicious transaction monitoring

³² FATF. Guidance for a Risk-based Approach: Virtual Assets and Virtual Asset Service Providers. Available at <https://www.fatf-gafi.org/media/fatf/documents/recommendations/RBA-VA-VASPs.pdf>

to VASPs. Customer due diligence is required for transactions above US\$ or EUR 1,000;

- v. designate a competent authority – not a self-regulatory body – to be responsible for VASPs' licensing or registration, monitoring and supervision;
- vi. require competent authorities to:
 - a. take necessary legal or regulatory measures to prevent criminals or their associates from holding, or being the beneficial owner of, a significant or controlling interest, or holding a management function, in a VASP; and
 - b. take steps to identify persons carrying on activities in virtual assets without the necessary licence or registration, and impose appropriate sanctions;
- vii. empower competent authorities to ensure VASPs' compliance with AML and CTF obligations, including the authority to conduct inspections, compel the production of information and impose sanctions; and
- viii. have a range of effective, proportionate and dissuasive sanctions to deal with VASPs that fail to comply with their AML/CTF obligations, including powers for supervisors to withdraw, restrict or suspend VASPs' licence or registration. Sanctions should apply to VASPs, their directors and senior management.

FATF also allows countries to prohibit virtual asset activities or VASPs to support other policy goals, such as consumer protection and monetary policy.

Application of FATF Guidance

The FATF Recommendations do not apply to a person who is not engaging in the various activities as a business for or on behalf of another person. Accordingly, an individual who uses virtual assets to purchase goods or services on their own behalf is not a VASP.

Further, depending on a jurisdiction's local laws, a virtual asset trading platform may not be a VASP if it simply provides a forum for buyers and sellers of virtual assets to post bids and offers and the parties trade at an outside venue (e.g. through individual wallets or wallets not hosted by the trading platform). However, if the platform facilitates the trade by buying the virtual assets from the seller and selling them to the buyer, it will be conducting exchange and/or transfer activity as a business on customers' behalf and will thus be a VASP subject to the requirements. Closed-loop items that are non-transferable, non-exchangeable and non-fungible such as airline miles and credit card rewards are also outside the scope of the VASP regulatory controls.

The "Travel Rule"

One of the most controversial provisions is the "travel rule" which requires countries to ensure that originating VASPs:

- i. obtain and hold the required originator and beneficiary information (including the name and account number of the originator and beneficiary and the originator's identification number);
- ii. transmit the information to the beneficiary VASP or financial institution (if any); and
- iii. make the information available on request to the appropriate authorities.

To comply with the travel rule, VASPs need to be able to identify when they are transacting with another VASP, as opposed to a private wallet and whether the counterparty VASP is licensed or registered in a jurisdiction and adequately supervised for AML/CTF purposes. Conducting timely counterparty due diligence in a secure manner is proving to be a challenge and one suggestion is for the creation of a global list of VASPs which would be accessible through a central database or through an API which connects to each jurisdiction's list. The creation of a global list raises a number of challenges such as who would be responsible for ensuring the accuracy and security of the information. Another difficulty is that peer-to-peer transfers not involving a VASP or financial institution are not explicitly subject to AML/CTF obligations leaving VASPs uncertain as to how they should transact with private or unhosted wallets.

FATF's June 2020 Report³³ notes that there has been less implementation of the travel rule than other AML/CTF requirements and that several jurisdictions saw the travel rule as a significant challenge to implementing the revised Recommendations. FATF however did not consider the issues raised around technology solutions to be fundamental barriers to adopting the travel rule.

Implementation Requirement of the FATF Recommendations

When the FATF revised its Recommendations to cover virtual assets in June 2019, its expectation was that member countries should apply them promptly to virtual asset activities and service providers. In its 12 Month Review³⁴ of the implementation of the Recommendations published in June 2020, FATF noted that 24 FATF members and 8 members of FATF-Style Regional Bodies (FSRBs) had introduced a regulatory regime regulating VASPs and one FATF member and 2 FSRBs had prohibited VASPs. 19 jurisdictions (13 FATF members and 6 FSRB members) had not yet implemented a regime regulating VASPs. Most jurisdictions which have introduced new legislation to regulate VASPs did so by adding VASPs as an obliged entity under their existing law.

An example of regulation aimed at FATF compliance is the European Union's (EU) fifth money laundering directive (5MLD) which requires virtual asset service providers to be registered, and meet the requirements of the EU's anti-money laundering regime. EU member states were required to implement the requirements of the fifth money laundering directive into local law by 10 January

³³ FATF. June 2020. 12-Month Review of the Revised FATF Standards on Virtual Assets and Virtual Asset Service Providers. Available at: <https://www.fatf-gafi.org/media/fatf/documents/recommendations/12-Month-Review-Revised-FATF-Standards-Virtual-Assets-VASPS.pdf>

³⁴ Ibid.

2020. Subsequently, the 6th Anti-money Laundering Directive (6MLD) entered into force. Member states were required to transpose the 6MLD into national law by 3 December 2020, while all relevant financial institutions have 6 months (that is until 3 June 2021) to implement it.

The main updates to the AML regime under the 6MLD include:

- a harmonised definition of money laundering offences;
- an enhanced definition of “criminal activity” which has been narrowed down to 22 predicate offences (offences which enable more serious crimes such as money laundering or terrorist financing);
- an increase in the minimum prison sentence for natural persons for money laundering offences from one year to four years; and
- the extension of criminal liability to legal persons. This means that organisations operating in EU member states may be held criminally liable for failure to prevent illegal activity conducted by a “directing mind” within the company. The sanctions and penalties include disqualifications from commercial activities, undergoing judicial supervision and temporary or permanent closure of establishments.

The 6MLD also encourages the member states to collaborate in prosecuting firms/individuals in an effort to enhance enforcement. For example, the 6MLD prescribes that where a money laundering offence has occurred within the jurisdiction of more than one member state, the member states involved should cooperate in deciding which member state should prosecute it. The 6MLD provides factors for member states to consider for making this determination. These include: where the offence was committed, the nationality/residency of the offender, country of origin of the victims and the territory where the offender was found.

It is interesting to note that the UK has decided to opt out of complying with the 6MLD on the basis that, in the UK Government’s view, the UK’s domestic legislation already goes much further. Any UK businesses operating in the EU will however be required to comply with the requirements of the 6MLD.

Singapore has also passed legislation, the Payment Services Act of January 2019, which requires entities providing virtual asset dealing or exchange services to be licensed by the Monetary Authority of Singapore (**MAS**). The detailed AML/CTF requirements applicable to licensees are being imposed by notices issued by the MAS under the Monetary Authority of Singapore Act. In Hong Kong, crypto exchanges which are licensed by the SFC are required to comply with anti-money laundering and counter-terrorist financing obligations under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance and are specifically required to comply with any updates to the FATF Recommendations relating to virtual assets including INR15. Hong Kong currently only requires crypto exchanges to be licensed if they trade at least one cryptocurrency that is a “security” or “futures contract”. However, it is currently consulting on introducing a new licensing regime which will require crypto exchanges to be licensed even if they only trade cryptocurrencies that are not securities. These exchanges will also be subject to AML and CTF obligations under the AMLO.

Trends in Use of Virtual Assets for ML/TF purposes

Money laundering and terrorist financing is a risk associated with cryptocurrencies and understanding the trends in the use of virtual assets for these purposes is important in better understanding and effectively tackling these challenges.

The FATF has observed that in most detected cases, generally, only one type of virtual asset was used. Where more than one type of virtual asset was used, this typically involved the layering of illicit proceeds. Other than being used in money-laundering activities and commission of predicate offences, virtual assets were also used in fund-raising activities for terrorism and to evade financial sanctions. The most prominent typology observed in the detected cases was the use of virtual assets as a way of layering, possibly due to the ease of rapid transfer. Among the offences involving virtual assets, the most prevalent offences were narcotics-related and fraud offences.

The FATF has observed that the dominant trends in the virtual asset money-laundering or terrorist-financing risk landscape since June 2019 include:

- (i) the use of VASPs registered or operating in jurisdictions that lack effective AML/CFT regulation and the use of multiple VASPs (local and/or overseas); and
- (ii) the continued use of tools and methods to increase the anonymity of transactions. This includes the use of registering domain names and using domain name service providers which redact the identity of the true owners of the domain name.

Both trends make it more difficult to track and trace the transaction trail. In response to the ongoing COVID-19 pandemic, FATF jurisdictions have also observed the increased use of virtual assets to move and conceal illicit funds. For example, in one case, there was a report of virtual assets being used to launder proceeds earned from selling COVID-19 medicines.

Stablecoins – Increased ML/TF Risks

The risk landscape has also been impacted by the increased use of stablecoins and the recent proposals for the worldwide adoption and mass production of stable coins. The FATF's main concerns are that mass-adoption could lead to a substantial increase in the number of anonymous peer-to-peer virtual asset transactions occurring via unhosted wallets, since peer-to-peer transactions that do not involve the use of a VASP or other AML/CFT-regulated entity are not explicitly covered by the revised FATF Recommendations. A rapid expansion in the number and value of transactions not subject to AML/CFT controls under the revised FATF Recommendations would then present a material ML/TF vulnerability. Therefore, the FATF urges jurisdictions to analyse and address risk in a forward-looking manner and ensure that they have all the necessary tools and authorities in place before they are needed. Otherwise, enforcement can be challenging, particularly given the cross-border nature of transactions.

FATF and Stablecoins

FATF's concerns from an AML/CTF perspective in relation to stablecoins include those referred to below.

Anonymity

As with other virtual assets, anonymity is also a concern with stablecoins. In short, the concern stems from the fact that (as with other virtual assets) stablecoins have public, permissionless, and decentralised ledgers. Although the transaction ledger may be accessible and records transactions, the ledger may not record any customer identification information. As such, the FATF Recommendations are aimed at addressing these issues by placing certain AML/CTF obligations on VASPs which carry out these financial activities.

Global reach

The global reach of stablecoins heightens the AML/CFT risks. With the tendency of stablecoins to be mass-adopted, these risks are increased exponentially. While virtual assets are in certain circumstances used for cross-border transactions, the FATF Report notes that this is not a widely adopted practice due to the fact that virtual assets are not recognised or adopted in many jurisdictions, but also in part due to their volatility. However, stablecoins seek to make payments faster, cheaper and more efficient for cross-border payments and transfers. From an AML/CFT point of view, cross-border transfers are thought to pose a greater risk than domestic transfers. As such, cross-border transfers are subject to additional AML/CFT measures pursuant to FATF Recommendation 16. This is known as the 'travel rule' and it mandates that VASPs maintain and exchange information regarding the originators and beneficiaries of virtual asset transfers. However, this 'travel rule' only applies to transactions which involve a VASP or other AML/CFT entity and does not apply to unmediated peer-to-peer transactions via un-hosted wallets. This issue is compounded by the lack of implementation of the travel rule as discussed above.

Layering

The ability to swiftly exchange between virtual assets numerous times has the effect of disguising the origin of the funds which makes virtual assets susceptible to 'chain-hopping.' Simply put, chain-hopping is the practice whereby money is moved from one virtual asset to another and also moved across exchanges. This creates a complex 'track-record' or 'money-trail' that is almost impossible to track. This is equally a risk to stablecoins in circumstances where stablecoins can quickly be exchanged for virtual assets or fiat currency.

Potential for mass production

A criminal's ability to use virtual assets as a means of exchange depends to a degree on how freely available the virtual asset is and also how freely exchangeable the virtual asset is. Virtual assets may have characteristics that do not make them appealing for use by criminals which include, their unstable value, the fact that they may not generally be accepted as a means of payment and their complexity

of use. However, stablecoins are designed to overcome the value volatility issue associated with virtual assets. In addition, stablecoins are being integrated into pre-existing communication and messaging systems which will make them simpler and faster to use. These aspects of stablecoins make them attractive and more susceptible to criminal abuse.

FATF Recommendations and their Applicability to Stablecoins

The FATF studied five of the largest stablecoins to gain an understanding of whether or not the FATF Recommendations sufficiently cover stablecoins. From its assessment, the FATF concluded that its Recommendations do sufficiently apply to entities involved in the stablecoin ecosystem. Entities within the stablecoin ecosystem will have AML/CFT obligations under the FATF Recommendations if they meet the definition of a financial institution or a VASP as set out in Recommendation 15. Where central governance bodies exist within the stablecoin ecosystem, they will generally be obliged entities under the FATF Recommendations in the same way as other entities in the stablecoin ecosystem such as exchanges, transfer service providers and custodial service providers.

However, the FATF has identified some residual risks which include the following:

- (i) the risk associated with anonymous peer-to-peer transactions via un-hosted wallets (i.e. software hosted on a device that allows a person to store and conduct transactions in convertible virtual currencies without the intervention of third parties. This can be distinguished from a “hosted” wallet, where the wallet receives, transfers and stores convertible cryptocurrencies on behalf of account holders, typically done online or through a mobile app);
- (ii) risks from weak or non-existent AML/CFT regulation by some jurisdictions; and
- (iii) risks associated with stablecoins having a decentralised governance structure.

Jurisdictions’ Progress in Implementing the Revised FATF Recommendations

In order to assess the progress made by jurisdictions in implementing the revised FATF Recommendations on virtual assets and Virtual Asset Service Providers (**VASPs**), the FATF conducted a survey in March 2020 of its membership and its broader global network. 38 FATF members (37 jurisdictions and 1 regional organisation) and 16 FATF Style Regional Bodies (**FSRBs**) responded. The results of the survey indicate that, overall, jurisdictions have made progress in implementing the revised FATF Recommendations (that is Recommendation 15 and its Interpretative Note to Recommendation 15 (**INR.15**)). Among the responding jurisdictions, 35 jurisdictions had implemented regimes for VASPs, while 19 jurisdictions did not have regimes for VASPs yet. For jurisdictions that established regimes for VASPs, 32 jurisdictions introduced regulatory regimes permitting VASPs while 3 jurisdictions prohibited VASPs. Among jurisdictions that had not yet implemented regimes for AML/CTF, the majority (13) intended to regulate VASPs, 2 intended to prohibit VASPs and 4 had yet to decide.

The travel rule

One of the challenges that the FATF Report highlighted was the global implementation of the travel rule. VASPs are required to implement the FATF's AML/CTF preventive measures in Recommendations 10-21 set out in INR.15. This includes Recommendation 16 (R.16), which sets out wire transfer requirements and is a key measure to ensure that the originators and beneficiaries of financial transactions are identifiable and are not anonymous. VASPs and financial institutions must comply with these requirements for virtual asset transfers. This is the so-called 'travel rule'.

Although the FATF is technology neutral and does not prescribe a particular technology software, the FATF Guidance on virtual assets and VASPs published in June 2019 lists a range of technologies which may enable VASPs to comply with aspects of the travel rule requirements. However, the FATF Report explained that there was no technological solution(s) that enabled VASPs to comply with all aspects of the travel rule in a holistic, instantaneous and secure manner.

Notwithstanding these concerns, the FATF Report explained that jurisdictions have made progress in the development of certain technologies to provide a solution to the travel rule.

There seems to have been progress in developing technological solutions for the travel rule which includes:

- (i) progress in the development of technological standards for use by different travel rule solutions. An international industry-wide initiative has been established to set global technical standards for travel rule solutions. A first messaging standard that sets a common universal language for the communication of the required originator and beneficiary information between VASPs was developed. This initiative may now be undertaking work on further messaging standards and the maintenance of this standard;
- (ii) several different travel rule solutions are being developed. In line with the decentralisation ethos that underpins virtual assets, there appears to be a greater desire for multiple potential solutions, as compared to one centralised travel rule solution. However, the FATF Report explained that use of a common standard will assist in ensuring that different computer systems or software are able to exchange and make use of the information which is exchanged pursuant to the travel rule; and
- (iii) from a jurisdictional point of view, the FATF Report highlighted that, of the FATF Recommendations, there has been lower implementation/adoption of the travel rule when compared to the other AML/CTF requirements. Of the 32 jurisdictions that had implemented the AML/CTF regulatory requirements for VASPs, 15 jurisdictions advised they introduced Recommendation 16 requirements for VASPs. This delayed enforcement of the requirement can be attributed to the lack of adequate holistic technology solutions, highlighting the importance of the need for the swift development of technological solutions.

Notwithstanding the aforementioned concerns in relation to the travel rule, the FATF Report explained that these concerns are not obstacles which will prevent the development of technological solutions to implement the travel rule. As such, the FATF Report urged VASPs to increase their efforts towards a swift development of holistic technological solutions to cover the entirety of the travel rule.

A key aspect of the implementation of the travel rule is the ability of a VASP to identify the counterparty VASP. Compliance with the travel rule requires that VASPs must be able to identify:

- i. when they are transacting with another VASP as opposed to transacting with a private wallet; and
- ii. whether the counterparty VASP is registered/licensed by the jurisdiction and is adequately supervised for AML/CTF purposes.

The FATF Report notes that the best way to conduct this due diligence on the counterparty is to do so in a timely and secure manner. A possible solution to the obstacles faced by VASPs is to create a global VASP list. This approach would require that information be collected from each jurisdiction on the VASPs registered/licensed in that particular jurisdiction which would then be accessed via a central database. However, this 'central data base' approach has its own challenges which include, but are not limited to, ensuring the information on the data base is secure, assigning responsibility for maintenance and accuracy of the data, determining who would supervise the bodies responsible for collecting the information and deciding who would have access to the information.

Peer-to-peer transactions via private/ unhosted wallets

Peer-to-peer transfers of virtual assets, without the use or involvement of a VASP or financial institution, are not explicitly subject to AML/CTF obligations under the revised FATF Recommendations. This has resulted in many VASPs being unsure of the required approach in such circumstances and they have raised queries as to what approach is required when transacting with private or unhosted wallets.

Concerns have been raised regarding the extent to which a wallet can be identified as a custodial vs a non-custodial wallet, causing some VASPs to ask for guidance on the extent to which blockchain analytic tools can be used in complying with the travel rule requirement.

A further concern that has been raised is whether VASPs should be able to transact with private wallets, and if so, what kind of AML/CTF requirements need to be put in place to mitigate the risks. When considering this issue, some VASPs have raised the risk of unnecessarily burdensome AML/CTF compliance obligations (including the travel rule), which may incentivise greater use of peer-to-peer transactions via unhosted wallets and raise the risks and require further mitigation measures.

Batch and post facto submission and past transfers

Some VASPs have also requested guidance on the following:

- (i) the extent to which the batched data submission of transfers of originator and beneficiary data is permissible under the revised FATF Recommendations;
- (ii) whether originator and beneficiary data could be submitted on a post facto basis (e.g. at the end of the day, or 5 to 6 business days later) instead of immediate data submission on an individual virtual asset transfers; and
- (iii) the extent to which beneficiary and originator data should be collected on past virtual asset transfers.

Inter-operability of systems

For the smooth global implementation of the travel rule, different solutions need to be of such capability that different computer systems and software are able to exchange and make use of the information being shared. This also requires that the technology must have in place adequate controls to address data sharing, storage and security

The first step to ensuring interoperability of systems is the development of global messaging standards. However, fragmentation may be driven by the different rules and standards adopted in different jurisdictions for areas such as privacy and data protection, cyber-security or AML/CTF.

The inter-operability of different travel rule solutions may then be impacted, unless (i) sufficient flexibility is being built into the messaging standards, or (ii) solutions are being developed to accommodate the requirements of particular jurisdictions.

This highlights the importance of close co-operation with and within the private sector and amongst jurisdictions in developing their AML/CTF regimes and supervisory approaches.

Sunrise issue

As less than half of FATF members have introduced travel rule requirements, there is a lack of a global framework for travel rule compliance. This poses a challenge to VASPs, since it is unclear what approach they should take in dealing with VASPs located in jurisdictions without the travel rule.

Specific wording issues

Several specific wording issues in the FATF guidance regarding R.16 for VASPs were raised, including references to the Legal Entity Identifier, the term 'account number' and the address of an originator.

Implementation of the other AML/CTF obligations

The FATF Report noted that the adoption and implementation of the AML/CTF obligations globally is at an early stage. This is partly due to the fact that many VASPs may be unfamiliar with the fundamentals of AML/CTF as they may

previously have had no regulatory oversight. This is said to be compounded by the speed at which the VASP sector develops and changes.

That being said, jurisdictions which already have a developed AML/CTF regime for VASPs and have imposed such on their VASPs have reported an improvement in overall compliance, with increasing awareness and attention to AML/CTF obligations. This is particularly apparent in larger well established VASPs.

CRYPTO REGULATION IN HONG KONG

Hong Kong regulates entities conducting activities in cryptocurrencies where the relevant cryptocurrencies are “securities” or “futures contracts” as defined in Hong Kong’s Securities and Futures Ordinance (**SFO**). Intermediaries conducting regulated activities in relation to cryptocurrencies that are securities or futures contracts are required to be licensed or registered by Hong Kong’s Securities and Futures Commission (**SFC**) and must comply with the anti-money laundering (**AML**) and counter-terrorist financing (**CTF**) requirements of Hong Kong’s Anti-Money Laundering and Counter-Terrorist Financing Ordinance (the **AMLO**). However, the vast majority of cryptocurrencies (such as Bitcoin) are not securities. The SFC has however imposed specific regulatory requirements on fund managers and managers of discretionary investment portfolios which invest in cryptocurrencies which are not securities in addition to traditional securities. Similar requirements apply to distributors of cryptofunds even where the funds only invest in cryptocurrencies that are not securities or futures contracts. Operators of exchanges which trade cryptocurrencies are currently only required to be licensed by the SFC where the exchange trades at least one cryptocurrency that is a security. Licensed exchanges are subject to stringent licensing conditions.

Cryptocurrencies are also not regulated by Hong Kong’s other financial regulators. The Hong Kong Monetary Authority (**HKMA**) has said that it does not regulate cryptocurrencies such as Bitcoin which it regards as a virtual “commodity” and not as legal tender, or a means of payment or money.³⁵ Hong Kong’s banking laws and regulations therefore do not apply to entities accepting or dealing in cryptocurrencies.

The Money Service Supervision Bureau of the Customs and Excise Department has also said that Bitcoin and other similar virtual commodities are not money for the purposes of the AMLO, and are thus outside the scope of its regulatory regime for money service operators.³⁶

However, on 3 November 2020, Hong Kong’s Financial Services and Treasury Bureau (the **FSTB**) published a consultation on proposals to introduce a new licensing regime under the AMLO for virtual asset exchanges that are not required to be licensed under the SFO because they only trade cryptocurrencies that are *not* securities or futures contracts. The proposals will require virtual asset exchanges to be licensed by the SFC and comply with the AML and CTF obligations set out in Schedule 2 to the AMLO and the SFC will monitor and enforce

³⁵ HKMA. Press release “*The HKMA reminds the public to be aware of the risks associated with Bitcoin*”. 11 February 2015.

³⁶ Money Service Supervision Bureau. Customs and Excise Department. “*Statement in relation to Bitcoin and Money Service Operator Licence*”. August 2014.

compliance with these obligations. Exchanges will also be subject to stringent licensing conditions which will be broadly the same as those imposed on exchanges licensed under the SFO in order to create a level playing field. If implemented, the new regime will fulfil FATF's requirements for virtual asset exchanges. Hong Kong is not however considering regulating other entities within the FATF's definition of virtual asset service providers or VASPs at this stage, such as certain types of wallet providers.

For the purposes of this note, the terms "cryptocurrency" and "virtual asset" are used interchangeably.

1. REGULATORY STATUS OF CRYPTOCURRENCIES

Hong Kong's regulators generally consider cryptocurrencies such as Bitcoin and Ether to be "virtual commodities" which are not regulated in Hong Kong. However, as noted in its September 2017 [Statement on initial coin offerings](#),³⁷ the SFC determines the regulatory status of cryptocurrencies on a case-by-case basis depending on whether they carry rights equivalent to traditional securities, for example if:

- i. they carry rights similar to those provided by shares, such as a right to a portion of the issuing company's profits or surplus assets on winding up;
- ii. they have rights similar to debentures such as a right to repayment of the purchase price; or
- iii. they are similar in nature to an interest in a Collective Investment Scheme (or **CIS**) where the purchase price will be invested in assets or projects and any return will be distributed to the holders.

Very few cryptocurrencies have features similar to shares or debentures.

There is a question mark as to whether cryptocurrencies could be considered to be interests in a CIS, particularly given the lack of Hong Kong case law on the SFO's definition of a "collective investment scheme". The essential features of a CIS under the SFO are that:

- i. it must involve an arrangement in respect of property (property is broadly defined);
- ii. the participants do not have day-to-day control over the management of the property (even if they have the right to be consulted or to give directions about the management of the property);
- iii. the property must be managed as a whole by or on behalf of the person operating the arrangements, and/or the participants' contributions and the profits or income are pooled; and

³⁷ SFC. "[Statement on Initial Coin Offerings](#)". 5 September 2017

- iv. the purpose of the arrangement should be to provide participants with profits, income or other returns from the acquisition or management of the property.

There have been no court decisions on the meaning of “collective investment scheme” in Hong Kong and whether or not any particular ICO falls within the definition will depend on the facts and circumstances of the ICO and ultimately, the courts’ interpretation of the statutory definition.

1.1 ICOs

Most ICOs in Hong Kong, as elsewhere, have typically been structured as offers of “utility tokens”, (tokens which give holders rights to access a product or service provided by the platform either now or in the future) which the SFC’s February 2018 statement³⁸ suggested are outside the scope of Hong Kong’s securities legislation. The SFC noted that ICO issuers it had contacted either confirmed that their tokens did not constitute securities or ceased to offer tokens in Hong Kong. Similarly, crypto exchanges contacted by the SFC reportedly also confirmed that they only trade non-security tokens or ceased to sell tokens which could be securities. The SFC has not published the names of the relevant ICO issuers or provided any further guidance on the features of an ICO token which are likely to render it a security.

Despite writing to a number of ICO issuers asking for confirmation that their ICO tokens were not securities, the SFC has only put a stop to one ICO – Black Cell Technology’s ICO in March 2018 on the basis that the offering may have been a collective investment scheme.³⁹ However, this was an extreme case since the tokens sold in the ICO were redeemable for equity shares in the ICO issuer, Black Cell. The SFC’s regulatory action resulted from concerns that Black Cell had engaged in potential unauthorised advertising activities in contravention of Section 103 of the SFO and may have breached the SFO’s licensing requirements, although it did not specify which regulated activity was involved. Black Cell stopped ICO transactions with Hong Kong investors and undertook not to establish or market any CIS except in compliance with the SFO.

While Hong Kong saw a number of ICOs in 2017 and 2018, ICO activity in Hong Kong has virtually ceased in 2019 and 2020 following repeated warnings from the SFC. The lack of activity may also be due to the lack of clarity as to the features of an ICO token which would bring it within the definition of a security, which is also true in many other jurisdictions.

1.2 Securities Token Offerings (STOs)

STOs emerged in 2017 (with two STOs raising collectively US\$22 million) and began to pick up in 2018 (with a total of 28 STOs raising US\$442 million) and 55 in 2019 (raising US\$452 million). Security tokens were then heralded in some quarters as the “next big megatrend” in the blockchain revolution, however this is yet to

³⁸ SFC. “[SFC warns of cryptocurrency risks](#)”. 9 February 2018

³⁹ SFC. “[SFC’s regulatory action halts ICO to Hong Kong public](#)”. 19 March 2018

materialise, with some citing the lack of a secondary market for tokenised securities, an undeveloped regulatory environment and high upfront costs.⁴⁰ However, there has been steady growth. The value of the STO market is expected to grow from US\$983 million in 2018 to US\$2.6 billion by 2023, particularly in view of the institutionalisation of the digital asset ecosystem.⁴¹

STOs can be differentiated from ICOs however as while ICOs sought to position themselves outside the securities regulatory framework, STOs are being used in some jurisdictions, notably the US, to bring crypto assets within the regulatory net as a means to achieve regulatory certainty, which means greater certainty for fundraisers and investors alike. Despite this, STOs have not been popular in Hong Kong as yet as it is still very uncertain how the Hong Kong regulatory framework applies to security token offerings, and more fundamentally, as to the characteristics which make a cryptocurrency a security token in the first place.

(a) SFC Statement on Security Token Offerings

The SFC issued a [Statement on Security Token Offerings](#)⁴² (or **STOs**) on 28 March 2019 setting out the regulatory requirements applicable to STOs and reiterating the SFC's earlier warnings to the public of the potential risks involved in investing in digital assets.

What does the SFC consider to be a security token?

The SFC describes security tokens as digital assets which have the features of traditional securities, including tokens which represent economic rights such as a share of profits or revenue. Thus, tokens which are essentially tokenised shares (e.g., entitling holders to a share of profits in the form of a dividend or to participate in the distribution of the issuer's assets on winding up) will be a security token, and thus a security under Hong Kong law. Similarly, a token which has the features of a debt or liability owed by the issuer, will likely be a "debenture" for the purposes of Hong Kong's securities laws.

According to the SFC's March 2019 statement, a token representing ownership of assets, such as gold or real estate, would also amount to a security token, although the SFC does not elaborate on why this should be the case. The SFC may be alluding to what is essentially a tokenised real estate or gold fund - where money raised from a token offering is invested in gold or real estate on the understanding that token holders will receive a share of the future proceeds of sale of the gold/real estate when sold at a profit. In that case, the tokens would likely constitute securities as interests in a collective investment scheme under the SFO.

⁴⁰ Cointelegraph. "What's happened with the so-called next big thing in fintech?" 13 July 2020. Available at: <https://cointelegraph.com/news/sto-whats-happened-with-the-so-called-next-big-thing-in-fintech>

⁴¹ <https://www.lcx.com/sto-market-size-the-state-of-the-industry-of-tokenization-and-security-token-offerings/>

⁴² SFC. Statement on Security Token Offerings. 28 March 2019. Available at: <https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/Statement-on-Security-Token-Offerings>

Alternatively, the SFC could be suggesting that tokens whose value/price is linked to the value/price of an underlying commodity such as gold or real property constitute either “regulated investment agreements” or “structured products” under the SFO definitions.

Structured products

Structured products are defined broadly and include any product where all or part of the return or amount due (or both), or the settlement method, is determined by reference to any one or more of:

- i. changes in the price, value or level (or within a range) of securities, commodities, indices, property, interest rates, currency exchange rates or futures contracts, or any combination or basket of any of these; or
- ii. the occurrence or non-occurrence of any specified event(s) other than an event relating only to the issuer and/or the guarantor of the product.

The SFC’s March 2019 statement suggests that, depending on how the tokens are structured, tokens representing an underlying asset could constitute structured products subject to Hong Kong’s securities laws. There has been no official guidance from the SFC on how it would regard stablecoins that are pegged to the price of assets such as gold or fiat currencies whose value may appreciate or not. Unlike jurisdictions such as the US, Hong Kong does not regulate commodities such as gold. It would therefore be illogical for a token representing a commodity, which is more akin to a deposit slip than a security, to be regarded as a security subject to Hong Kong’s securities regulatory regime. The Financial Services and Treasury Bureau’s (the **FSTB**) November 2020 Consultation Paper proposing a licensing regime for exchanges trading non-security cryptocurrencies confirmed that cryptocurrencies that are backed by assets for the purpose of stabilising their value are virtual assets for the purposes of the proposed new licensing regime. Thus, an exchange trading stablecoins which are not securities will need to be licensed under the new AMLO licensing regime when it is implemented.

Regulated investment agreements

A ‘regulated investment agreement’ is an agreement, the purpose or effect is to provide to any party to the agreement a profit, income or other return calculated by reference to changes in the value of any property (e.g., equity-linked deposits) (but does not include a collective investment scheme).

Unless a security token offering is essentially a tokenised fund offering which is a collective investment scheme, there seems to be little support for the SFC’s statement that tokens representing digital ownership of assets such as gold or real estate constitute securities under the SFO. Further guidance on this from the SFC would be welcome.

(b) Regulatory Implications of STOs being “securities” under the SFO

Selling restrictions

The SFC's March 2019 statement on STOs provides that where an intermediary markets or distributes security tokens, it should only offer them to professional investors. An offer of security tokens only to professional investors as defined in the SFO has the advantage of being exempt from the requirement for SFC authorisation of any advertisement or invitation issued in relation to an offer of securities (under section 103 SFO) where the security tokens are offered to more than 50 persons in Hong Kong.

Where STO tokens constitute interests in a collective investment scheme, restricting the offer to professional investors will mean that the stringent requirements of the SFC's Code on Unit Trusts and Mutual Funds will not apply. Those requirements would likely render an STO unworkable given:

- the requirements for the appointment of a qualified fund manager and a custodian that is a bank or trust company registered under the Trustee Ordinance; and
- the investment restrictions applicable to retail funds which include a prohibition on real estate investment and a restriction on investing no more than 15% of the fund's net asset value in investment products that are not listed on the HKEx or another recognised stock exchange.

Licensing Requirements for Intermediaries Marketing / Distributing Security Tokens

Where crypto assets are "securities" under the SFO, any exchange which provides trading in the security tokens and any intermediary which markets and distributes the security tokens must be licensed or registered by the SFC for Type 1 regulated activity (dealing in securities), and each of its staff members conducting trading or marketing of security tokens must also be licensed for Type 1. The SFC states in its March 2019 statement that security tokens should only be offered to professional investors.

Conduct Requirements for Licensed Intermediaries

STO suitability for intermediaries' customers

Intermediaries which market and distribute security tokens must comply with the conduct provisions of the SFC's Code of Conduct, in particular the requirement under paragraph 5.2 to ensure that customer recommendations and solicitations with respect to security tokens are reasonably suitable for the particular customer, given the information about the particular customer of which the intermediary is or should be aware through the conduct of due diligence.

Intermediaries should also refer to the SFC's Suitability FAQs and FAQs on Triggering the Suitability Obligations. Although not referred to in the SFC statement, all licensed intermediaries are also under an obligation to conduct customer due diligence and anti-money laundering checks on their customers and these apply irrespective of the type of product being recommended or the subject of a customer solicitation.

STOs as Complex Products

The SFC regards security tokens as “complex products” as defined under paragraph 5.5 of the Code of Conduct. Paragraph 5.5 imposes additional obligations on licensed intermediaries which make recommendations or solicit investors with respect to complex products. In particular, licensed intermediaries and their licensed staff are required to ensure that:

- (a) the security token is suitable for the client in all the circumstances;
- (b) the client is provided with sufficient information on the key nature, features and risks of the security token to understand it before making an investment decision; and
- (c) the client is provided with clear warning statements about the security token’s distribution.

Intermediaries’ Due Diligence Obligations

The SFC’s March 2019 statement mentions the need for intermediaries who market or distribute security tokens to conduct proper due diligence on the offering which should cover (among others):

- the background and financial soundness of the management, development team and the issuer of the security token; and
- the existence of and rights attached to the assets which back the security token.

Licensed intermediaries are also required to study security tokens’ whitepapers and all relevant marketing materials and other published information. The SFC’s March 2019 statement also notes intermediaries’ obligation to ensure that information provided to customers in respect of an STO is accurate and not misleading. This is the first time the SFC has raised the issue of the standard of due diligence it expects in relation to security token offerings and intermediaries’ responsibility for the accuracy of information.

Information to be Provided to Customers

Intermediaries should provide their customers with clear and comprehensible information on STOs which should include prominent warning statements alerting potential investors to the risks associated with digital assets. The SFC reminds licensed intermediaries to implement adequate systems and controls to ensure compliance with their regulatory obligations prior to engaging in security token distribution.

Requirement to Notify the SFC before Dealing in Security Tokens

The SFC also requires licensed intermediaries to notify it in advance prior to conducting any business in security tokens.

Shortcomings of the SFC's Regulatory Approach

A loophole in the SFC's regulatory approach to security token offerings is that the investor protection driven measures of the SFC Code of Conduct (the obligation to ensure the suitability of investment products for individual clients, anti-money laundering and counter-terrorist financing obligations etc.) only apply where a traditional intermediary is involved. The SFC Code of Conduct does not apply to issuers of securities and thus, on a typical security token offering, there is no obligation on the issuer to ensure the accuracy of the information provided in its marketing documents nor to assess the suitability of its tokens for prospective purchasers.

Additionally, token issuers and their designers and developers are typically based offshore, outside the regulatory remit of the SFC, and so, protection for Hong Kong investors against fraudulent or incompetent issuers is scant. The SFC Code of Conduct requirements referred to in the SFC's March 2019 Statement will only ever apply where a Hong Kong SFC licensed or registered intermediary is engaged to market the tokens to Hong Kong investors – a scenario which has not yet occurred in Hong Kong. However, if security tokens are to be traded on a Hong Kong crypto exchange, the operator of the exchange will need to be licensed and thus secondary market trading will be subject to SFC regulation.

Under the SFO, security tokens, in the same way as traditional securities, cannot be marketed to Hong Kong investors except by an SFC Type 1-licensed entity. However, if security tokens are not “actively marketed” to the Hong Kong public, there is nothing to prevent Hong Kong investors from subscribing for tokens via an offshore platform and in this situation, none of the SFC Code of Conduct's investor protection mechanisms will apply. Further, if the offering turns out to be a scam, Hong Kong investors have no means of redress other than a contractual claim or common law action against the token issuer. Given that whitepapers generally do not even contain the issuer's legal name and registered address, this route to recovering losses will not be straightforward.

These issues are of course by no means unique to Hong Kong and regulators worldwide face similar challenges.

1.3 Virtual Asset Futures and CME and CBOE Bitcoin Futures

Virtual asset futures contracts are largely unregulated, highly leveraged and subject to extreme price volatility which urged the SFC to issue a [statement](#) warning investors of the risks in November 2019.⁴³ The SFC noted in the same statement that trading platforms or persons which offer and/or provide trading services in virtual asset futures contracts without being licensed under the SFO may be in breach of the SFO. Virtual asset futures contracts may also constitute “contracts for differences” under the Gambling Ordinance which may be illegal unless authorised under that ordinance.

⁴³ SFC. SFC issues warnings on virtual asset futures contracts. 6 November 2019. Available at: <https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/SFC-issues-warnings-on-virtual-asset-futures-contracts>

Further, according to the [SFC Circular on Bitcoin futures contracts and cryptocurrency-related investment products](#) of December 2017,⁴⁴ a Hong Kong entity which enables Hong Kong investors to trade Bitcoin futures contracts which are traded on the Chicago Mercantile Exchange (the **CME**) or Chicago Board Options Exchange (the **CBOE**), including by relaying or routing orders for these Bitcoin futures contracts, will need to be licensed by the SFC for Regulated Activity Type 2 (dealing in futures contracts). These intermediaries are also expected to strictly observe the suitability requirement of paragraph 5.2 of the SFC Code of Conduct and the conduct requirements in relation to providing services in derivative products to clients under paragraphs 5.1A and 5.3 of that Code.

2. THE LICENSING REGIME UNDER THE SECURITIES AND FUTURES ORDINANCE

The SFO gives the SFC authority over the securities and futures industry, which only gives it authority over entities conducting business activities in the very limited category of cryptocurrencies which are “securities” or “futures contracts” within the statutory definitions. The SFC has however issued statements which bring the following within the scope of the licensing regime under the SFO:

- i. firms managing funds that invest in virtual assets (in addition to traditional securities or futures contracts);
- ii. firms distributing funds which invest in virtual assets (irrespective of whether they are securities or not); and
- iii. exchanges providing trading services in virtual assets where at least one virtual asset is a security or futures contract.

However, despite many of the world’s largest crypto exchanges operating in Hong Kong, these currently remain unlicensed since they are outside the scope of the SFC’s licensing regime as they only trade cryptocurrencies (such as Bitcoin and Ethereum) which are not “securities” or “futures contracts” under the SFO (“**non-SF virtual assets**”). Thus, an exchange which only trades non-SF virtual assets or a firm which only manages funds investing in non-SF virtual assets is completely unregulated at present. Primary market issues and offers of cryptocurrencies (such as ICOs) which are not securities are also unregulated.

2.1 Regulation of Virtual Asset Portfolio Managers

As outlined, the SFC’s regulatory jurisdiction under the SFO does not extend to activities in the many cryptocurrencies (including the most widely traded, such as Bitcoin and Ethereum) which are not securities or futures contracts (i.e. non-SF virtual assets). The SFC has issued a number of warnings to potential investors of the risks of investing in cryptocurrencies.

⁴⁴ SFC Circular to licensed corporations and registered institutions on Bitcoin futures contracts and cryptocurrency-related investment products. 11 December 2017. Available at: <https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=17EC79>

In November 2018, the SFC published a [regulatory framework](#) which deals with its regulation of portfolio managers which invest in cryptocurrencies which are not securities or futures contracts. Portfolio managers include both fund managers and managers of discretionary accounts (in the form of an investment mandate or a pre-defined model portfolio). The statement extends the SFC's regulation of the activities of licensed portfolio managers to cover their crypto-related services.⁴⁵ Where a firm is already or will be licensed for Type 9 regulated activity (asset management) for managing portfolios in traditional securities and/or futures contracts, its management of portfolios (or portions of portfolios) which invest in cryptocurrencies which are not securities or futures contracts is also subject to the SFC's oversight. The SFC exercises oversight over the firm's crypto-related activities through the imposition of [licensing conditions](#).⁴⁶

However, a portfolio manager which only manages funds which invest only in cryptocurrencies which are not securities or futures contracts does not need to be licensed for Type 9 regulated activity since managing funds investing only in cryptocurrencies that are not securities or futures contract is not a regulated activity. To the extent that the portfolio manager distributes the fund in Hong Kong, it will however need to be licensed for Regulated Activity Type 1 (dealing in securities) (see further at 2.2 below).

(a) De minimis provision

The additional licensing conditions are subject to a *de minimis* provision: they apply to firms which manage or plan to manage virtual asset funds or investment portfolios which:

- have a stated investment objective to invest in virtual assets; or
- intend to invest or have invested more than 10% of their gross asset value (**GAV**) in virtual assets directly or indirectly).

The licensing conditions do not however apply to:

- licensed corporations which only manage funds/portfolios investing in virtual asset funds (i.e. funds of funds); or
- licensed corporations managing portfolios whose mandate is to invest mainly in securities and/or futures contracts and their investment in virtual assets exceeds 10% of GAV only because of an increase in the prices of the virtual assets held in one or more of the portfolios. The licensed corporation is required to take all reasonable steps to reduce the portfolio's investment in virtual assets below the 10% of GAV threshold. If, however, the position is expected to continue (i.e. virtual assets will continue to exceed 10% of GAV), the licensed corporation must alert the SFC which will consider imposing licensing conditions. Failure to notify the SFC may result in disciplinary action.

⁴⁵ SFC. "[Statement on regulatory framework for virtual asset portfolios managers, fund distributors and trading platform operators](#)". 1 November 2018

⁴⁶ SFC. "[Proforma Terms and Conditions for Licensed Corporations which Manage Portfolios that Invest in Virtual Assets](#)". October 2019.

(b) Requirement to notify the SFC

Licensed corporations and licence applicants are required to inform the SFC if they currently manage, or plan to manage, one or more funds/portfolios that invest in cryptocurrencies, or intend to hold cryptocurrencies on behalf of funds/portfolios under their management. The notification requirement applies even if the fund/portfolio intends to invest less than 10% of the portfolio's gross asset value in cryptocurrencies and whether or not the cryptocurrencies involved are "securities" or "futures contracts." Failure to inform the SFC may constitute a breach of the Securities and Futures (Licensing and Registration) (Information) Rules.

On being informed that a firm is managing or plans to manage virtual asset portfolios, the SFC will send the [standard licensing conditions](#)⁴⁷ to the firm and these may be varied following discussions with the firm according to its particular business model. Licensed corporations which do not agree to comply with the licensing conditions will be prohibited from managing virtual asset portfolios and must unwind their cryptocurrency positions.

A new licence applicant has to agree to the licensing conditions proposed, or its licensing application will be rejected.

(c) The Licensing Conditions

The SFC has published [Proforma Terms and Conditions for Licensed Corporations which Manage Portfolios that Invest in Virtual Assets](#)⁴⁸ that it will impose on a fund manager that manages a fund (or portion of a fund) that invests in virtual assets and meets the de minimis threshold (a **Virtual Asset Fund Manager**). The conditions are onerous and include the following principal obligations.

1. Restriction to professional investors and disclosure requirements

Investors in a fund with a stated investment objective of investing in cryptocurrencies or which intends to invest 10% or more of its GAV in cryptocurrencies are restricted to "*professional investors*" as defined in the SFO (including high net worth investors under the Securities and Futures (Professional Investor) Rules). If a virtual asset fund will be distributed through distributors, the Virtual Asset Fund Manager must implement measures to ensure that the fund is only distributed to professional investors.

2. Safeguarding of assets

Despite the SFC acknowledging that crypto funds face "*a unique challenge due to the limited availability of qualified custodian solutions*", the SFC has imposed onerous obligations on licensed Virtual Asset Fund Managers in relation to custodians.

A manager of a virtual asset fund is firstly required to assess and select the most appropriate custodial arrangement – that is whether to hold the assets itself or with a third-party custodian or an exchange - taking into consideration the advantages

⁴⁷ SFC. October 2019. "Proforma Terms and Conditions for Licensed Corporations which Manage Portfolios that Invest in Virtual Assets". Available at: [https://www.sfc.hk/web/EN/files/IS/publications/VA_Portfolio_Managers_Terms_and_Conditions_\(EN\).pdf](https://www.sfc.hk/web/EN/files/IS/publications/VA_Portfolio_Managers_Terms_and_Conditions_(EN).pdf)

⁴⁸ Ibid

and disadvantages of holding cryptocurrencies at different host locations by way of “hot” or “cold” wallets, considering (among others) the ease of accessibility to cryptocurrencies and the security of the custodial facility.

Virtual Asset Fund Managers are also required to exercise due skill, care and diligence in selecting, appointing and conducting on-going monitoring of custodians by reference to factors such as the custodian’s:

- (a) experience and track record in providing custodial services for cryptocurrencies;
- (b) regulatory status, particularly whether its cryptocurrency custodial business is subject to regulatory oversight;
- (c) corporate governance structure and the background of its senior management;
- (d) financial resources and insurance cover for compensating customers for loss of customer assets; and
- (e) operational capabilities and arrangements, for example, its “wallet” arrangements and cybersecurity risk management measures.

Where cryptocurrencies are held by the licensed fund manager itself, it is required to document the reasons for self-custody and disclose the risks of self-custody to investors. Appropriate measures must be implemented to protect the fund’s assets and to effectively segregate the cryptocurrencies from the fund manager’s own assets in the event of its insolvency. The fund manager is also required to use best endeavours to acquire and maintain insurance cover over the cryptocurrencies.

3. *Portfolio valuation*

The SFC recognises that there are currently no generally accepted valuation principles for virtual assets, particularly ICO tokens. The licensing conditions however require licensed corporations to select valuation principles, methodologies, models and policies which are *reasonably appropriate* in the circumstances and in the best interests of investors. These also need to be disclosed to investors.

4. *Risk management*

Virtual Asset Fund Managers are required to set appropriate limits for each product or market the fund invests in. They should, for example, consider setting a cap on a fund’s investment in illiquid cryptocurrencies and newly-launched ICO Tokens and its exposure to counterparties. According to the risk management procedures set out in Appendix 2 to the Proforma Terms and Conditions, Virtual Asset Fund Managers should consider using more than one custodian to hold the fund’s assets to avoid undue concentration of risk. Periodic stress testing is also required to assess the effect of abnormal and significant changes in market conditions on the fund.

Before transacting with a crypto exchange, a licensed Virtual Fund Manager is required to assess the reliability and integrity of the virtual asset exchange taking into account matters such as its:

- i. experience and track record;
- ii. legal or regulatory status;
- iii. corporate governance structure and background of its senior management;
- iv. operational capabilities;
- v. mechanisms (e.g., surveillance systems) implemented to guard against fraud and manipulation with respect to products traded on the exchange;
- vi. cybersecurity risk management measures; and
- vii. financial resources and insurance cover.

Exposure to individual crypto exchanges must be limited by setting appropriate caps.

5. *Auditors*

The SFC has noted that the accounting profession has no agreed standards and practices for how an auditor can perform assurance procedures to obtain sufficient audit evidence for the existence and ownership of virtual assets and ascertain the reasonableness of the valuations. Despite this, the SFC requires the appointment of an independent auditor to audit the financial statements of managed funds. The SFC also requires licensed corporations to consider auditors' experience and capability in checking the existence and ownership of virtual assets, and ascertaining the reasonableness of their valuation, in their selection of an auditor.

6. *Liquid capital*

A licensed fund manager which holds cryptocurrencies on behalf of the funds it manages is required to maintain liquid capital equal to the higher of HK\$3 million or the amount of its variable required liquid capital).

(d) SFC licensed crypto fund managers

To date, only one fund management firm, Venture Smart Asia Limited, has succeeded in obtaining a Type 9 asset management licence to manage funds investing in crypto assets. It is also licensed for regulated activities Types 1 and 4 and the firm acted as advisor to, and distributor of, the Bitcoin tracking fund launched by the firm's blockchain arm, Arrano Capital.⁴⁹

2.2 Regulation of Virtual Asset Fund Distributors

Fund distribution requires a securities dealer licence (Type 1) because a fund is a "collective investment scheme" which is a security irrespective of whether the fund invests in virtual assets which are securities or not. Accordingly, firms distributing virtual asset funds (whether as fund managers under an asset management

⁴⁹ The Standard. 21 April 2020. "HK first approved crypto fund eyes US\$100 million". Available at: [https://www.thestandard.com.hk/section-news/section/2/218298/HK-first-approved-crypto-fund-eyes-US\\$100m](https://www.thestandard.com.hk/section-news/section/2/218298/HK-first-approved-crypto-fund-eyes-US$100m)

licence or as fund distributors under a securities dealer licence) are required to comply with:

- the SFC's regulatory framework for licensed corporations including its Code of Conduct for Persons Licensed by or Registered with the SFC (the **Code of Conduct**), including (among others) Know-your-Client (**KYC**) and AML and CTF obligations, as well as an obligation to ensure the suitability of product recommendations and solicitations for particular clients; and
- additional requirements set out in the SFC's "[Circular to intermediaries on the distribution of virtual asset funds](#)"⁵⁰ of 1 November 2018 (the **SFC November 2018 Circular**) including extensive due diligence in relation to the virtual asset funds they distribute,⁵¹ their fund managers and counterparties.

A fund manager which only manages funds investing in cryptocurrencies that are not securities does not need to be licensed for Type 9. This is because "asset management" is defined in the SFO as the management of "securities" or "real estate". Managing a fund investing only in cryptocurrencies which are not securities is not therefore "asset management" and does not require a Type 9 licence.

However, the distribution of a fund which invests in cryptocurrencies that are non-securities will require the distributor (whether that is the fund manager or a third party distributor) to be licensed for Type 1 – dealing in securities. A fund is a collective investment scheme, which is within the SFO's definition of "securities", irrespective of the type of assets the fund invests in. A Type 9-licensed asset manager which also distributes the funds it manages can rely on the incidental exemption from need to be separately licensed for Type 1.

The SFC November 2018 Circular requires licensed corporations to comply with the SFC's Code of Conduct for Persons Licensed by or Registered with the SFC (the **SFC Code of Conduct**) in distributing virtual asset funds (both authorised and unauthorised). In particular, they must ensure the reasonable suitability of any recommendation or solicitation made to a client under paragraph 5.2 of the SFC Code of Conduct.

The SFC November 2018 Circular also sets out additional requirements which apply to distributors of virtual asset funds which:

- are not authorised by the SFC for retail distribution under section 104 SFO; and
- have a stated investment objective of investing in virtual assets or intend to invest or have invested more than 10% of their GAV in virtual assets (i.e. funds which the licensed corporation knows, or should reasonably have known, to be investing more than 10% of their GAV in virtual assets at the time it distributes the fund, unless it has been advised that the fund manager intends to reduce the fund's investment in virtual assets to below

⁵⁰ SFC. Circular to intermediaries: Distribution of virtual asset funds. 1 November 2018. Available at: <https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=18EC77>

⁵¹ The additional requirements will not apply to funds authorised by the SFC for retail distribution.

10% of the fund's GAV in the near future). The investment in virtual assets may be direct or indirect (i.e. through fund of funds and funds which invest in derivatives, for example, total return swaps, with virtual assets as the underlying).

Additional Requirements

The additional requirements that apply to licensed corporations distributing these funds include the following:

1. Selling restrictions

A distributor of a Virtual Asset Fund can only target professional investors as defined under the SFO. Except in the case of institutional professional investors (broadly, banks and regulated securities intermediaries), the distributor must also assess whether its clients have knowledge of investing in cryptocurrencies or related products before effecting a transaction on their behalf. A transaction can only be executed for a client without such knowledge, if this would be in the best interest of the client. However, the SFC has given no guidance on when a transaction can be considered as being in the client's best interests. For the purposes of the knowledge assessment, a licensed corporation can take into account a client's prior investment experience in private equity or venture capital or whether they have provided capital for a start-up business in the previous two years.

2. Concentration assessments

Licensed corporations must consider the aggregate amount to be invested by a client in virtual asset funds to be reasonable given the client's net worth.

3. Due diligence on virtual asset funds not authorised by the SFC

Licensed corporations will need to conduct extensive due diligence on virtual asset funds (unless they have been authorised by the SFC for retail distribution), their fund managers and parties providing trading and custodian services to the funds. However, licensed corporations' compliance with these obligations very much depends on the willingness of the various parties to disclose the required information. The assessments licensed corporations are required to make are difficult given the lack of developed standards in the industry. The due diligence is required to include (without limitation) an examination of the fund's constitutive documents and completion of a due diligence questionnaire, in addition to making enquiries of the fund manager to obtain an in-depth understanding of the matters referred to below.

The due diligence the SFC expects to be conducted in relation to the fund manager covers:

- (a) the fund manager's background, relevant experience and (where applicable) the track record of its senior management, including its chief investment, operation, risk and technology officers;
- (b) its regulatory status (e.g. whether it is subject to any regulatory oversight);
- (c) its compliance history (i.e. whether it has been subject to any disciplinary or regulatory actions);

- (d) its operations including its internal controls and systems, e.g.:
 - the existence of proper segregation of key functions (such as portfolio management, risk management, valuation and custody of assets) or of adequate compensating controls to prevent abuse;
 - who has authority to transfer assets from the fund or custodians and what safeguards are in place;
 - the persons responsible for, and the procedures for, reconciling transactions and positions, including the frequency of reconciliations; and
 - the methodology and the persons responsible for determining the pricing and assessment of the reasonableness of the determined price of cryptocurrencies;
- (e) the fund manager's IT infrastructure (e.g., in terms of security and access management); and
- (f) its risk management procedures (including concentration limits, counterparty risk management procedures, stop-loss arrangements and stress testing), its liquidity risk management policy and disaster recovery plan.

In terms of the due diligence the SFC expects a licensed distributor to conduct in relation to the fund, this should cover:

- (a) the fund's targeted investors;
- (b) list of instruments the fund intends to trade or invest in and any limitations on the size of its holding of ICO tokens, pre-ICO Tokens or other illiquid or hard-to-value instruments;
- (c) its valuation policy (especially for ICO Tokens, pre-ICO Tokens or other illiquid or hard-to-value instruments); and
- (d) the custody arrangement for the fund assets, including the policy on the allocation of assets to be kept at different host locations, such as exchanges, custodians, hot storage, cold storage;
- (e) its use of leverage and derivatives;
- (f) the fund's targeted risk and return per annum;
- (g) key risks (as described in "Information for clients" below); and
- (h) the fund's auditors and audited financial statements, including whether the fund has received a qualified audit opinion in the past, and whether the audited statements are up to date.

The SFC expects a licensed distributor to perform the following due diligence on the fund's counterparties that covers:

- (a) their legal and regulatory status (e.g. whether they are regulated by any authorities to undertake custody business or trade in cryptocurrencies);

- (b) their experience and track record in dealing in cryptocurrencies;
- (c) the robustness of their IT systems (including cybersecurity risk management measures) and contingency plans; and
- (d) their financial soundness and insurance coverage, e.g. whether they have insurance covering loss of customer assets.

4. *Provision of information to clients*

To assist clients in making informed investment decisions, licensed distributors are required to provide prominent warning statements covering certain risks including (among others):

- (a) the continuing evolution of virtual assets and how this may be affected by global regulatory developments;
- (b) price volatility;
- (c) potential price manipulation on exchanges or trading platforms;
- (d) lack of secondary markets for certain virtual assets;
- (e) that most exchanges, trading platforms and custodians of virtual assets are currently unregulated;
- (f) counterparty risk when effecting transactions with issuers, private buyers/sellers or through exchanges or trading platforms;
- (g) the risk of loss of virtual assets, especially if held in “hot wallets”;⁵² and
- (h) cybersecurity and technology-related risks.

For licensed fund managers which both manage funds investing in virtual assets and distribute those funds, the requirements should not prove problematic, particularly where they provide custody for the virtual assets. The requirements are likely to be much more problematic for Type 1-licensed fund distributors where the extent of due diligence they will be required to perform on third party funds, their fund managers and custody arrangements may not be practical.

2.3 Regulation of Virtual Asset Exchange/Platform Operators

The SFC’s approach to the regulation of operators of crypto exchanges/ trading platforms is set out in its November 2019 [Position paper: Regulation of virtual asset trading platforms](#).⁵³ According to that paper, the SFC will regulate trading platforms operating in Hong Kong only if they trade at least one cryptocurrency which is a security. Since the vast majority of cryptocurrencies are not securities, crypto exchanges which only trade cryptocurrencies that are not securities or futures contracts are not currently regulated. Indeed, the precondition that an

⁵² A “hot wallet” refers to a wallet used for holding virtual assets in an online environment which provides an interface with the internet, which is more susceptible to cyber-attacks.

⁵³ SFC. “[Position Paper: Regulation of virtual asset trading platforms](#)”. 6 November 2019.

exchange must trade at least one cryptocurrency which is a security (i.e., a security token) makes most ineligible for licensing even if they want to be licensed. More fundamentally, the SFC licensing framework applies only to centralised exchanges and not to decentralised exchanges on which investors trade on a peer-to-peer basis.

To date, the SFC has only licensed one crypto exchange. The SFC issued the first virtual asset trading platform licence on 16 December 2020 to OSL Digital Securities, a platform which will only provide services to professional investors which is one of the licensing conditions. The platform will be subject to the SFC's "close supervision" and the Terms and Conditions for Virtual Asset Trading Platform Operators.

(a) Licensing Conditions for Hong Kong Crypto Exchanges

The SFC will impose the following licensing conditions on crypto exchange operators (**Licensees**):

- a. services may only be provided to professional investors;
- b. the Licensee must comply with "Terms and Conditions for Virtual Asset Trading Platform Operators" (the **Terms and Conditions**);
- c. the SFC's prior written approval will be required for offering a new service or activity, or making a material change to an existing service or activity;
- d. prior written approval of the SFC must be obtained for any plan or proposal to add a product to a Licensee's trading platform;
- e. the Licensee must provide the SFC with monthly reports on its business activities in the format prescribed by the SFC; and
- f. the Licensee must engage an independent professional firm to conduct an annual review of its activities and prepare a report confirming compliance with the licensing conditions and all relevant legal and regulatory requirements.

As noted in paragraph (b), it is a licensing condition that the licensed platform operator must comply with the [Terms and Conditions for Virtual Asset Trading Platform Operators](#)⁵⁴ which focus on the platform's operations. A breach of any of the licensing conditions will constitute 'misconduct' under Part IX of the SFO and may also reflect adversely on the fitness and propriety of the platform operator to remain licensed.

The terms and conditions which a licensed crypto exchange operator must satisfy relate firstly to providing safe custody of cryptocurrencies. The SFC expects a Licensee to adopt an appropriate operational structure and use technology to protect its clients equivalent to those required of traditional financial institutions in the securities sector.

1. *Trust structure*

⁵⁴ SFC. Terms and Conditions for Virtual Asset Trading Platform Operators. Available at: https://apps.sfc.hk/publicreg/Terms-and-Conditions-for-VATP_10Dec20.pdf

Licensed platform operators must hold client assets on trust to enhance safekeeping of client cryptocurrencies and ensure that they are properly segregated from those of the platform operator. Any material legal uncertainties, particularly as to the nature of any legal claims they may have over cryptocurrencies traded by them on the platform, must be disclosed in full to clients.

The SFC mandates that client assets must be held through a company which is incorporated in Hong Kong which is a wholly-owned subsidiary of the licensed platform operator and holds a trust or company service provider licence under the AMLO.

There is uncertainty as to whether cryptocurrencies constitute 'property' under Hong Kong Law, which may affect a client's rights in insolvency proceedings. Notwithstanding this, the SFC has said that this should not preclude the implementation of an interim regulatory regime.

2. Hot and cold wallet storage

The SFC requires the segregation of customers' virtual assets. Licensed platform operators must store 98% of client cryptocurrencies in "cold wallets" (i.e. where private keys are kept offline) and limit their holdings of client virtual assets in "hot wallets" (i.e. where private keys are kept online rendering them vulnerable to external threats) to no more than 2%. Licensed platform operators must also minimise transactions out of the cold wallet in which a majority of client cryptocurrencies are held.

Platform operators are also required to have adequate processes in place for handling requests for deposits and withdrawals of client cryptocurrencies to guard against loss arising from theft, fraud and other dishonest acts, professional misconduct or omissions. The platform operator and its subsidiary holding the clients' cryptocurrencies must also set out in writing details of the mechanism for transferring cryptocurrencies between hot, cold and other storage and the procedures for dealing with events such as hard forks and air drops from an operational and technical perspective,

3. Insurance

Licensed platform operators must have an insurance policy covering the risks associated with the custody of cryptocurrencies held in both hot storage (full coverage) and cold storage (a substantial coverage) which is in effect at all times.

4. Private key management

The SFC expects a licensed platform operator to set up and implement strong internal controls and governance procedures for private key management to ensure all cryptographic seeds and keys are securely generated, stored and backed up.

SFC KYC Requirements for Crypto Exchanges

The SFC requires licensed platform operators to take all reasonable steps to establish the true and full identity of each of its clients, and of each client's financial situation, investment experience and investment objectives. Except for institutional and qualified corporate professional investors (as defined in the SFC Code of Conduct), before providing any services to the client, a platform operator must ensure that the client has sufficient knowledge of cryptocurrencies, including knowledge of the relevant risks associated with them. Where a client does not have that knowledge, services can only be provided to the client if the platform operator provides training to the client and enquires into the client's personal circumstances.

Concentration risks are also required to be assessed by setting a trading limit, position limit, or both by reference to the client's financial situation to ensure that the client has sufficient net worth to assume the risks and bear any potential trading losses.

Anti-Money Laundering (AML) and Counter Terrorist Financing (CTF) Requirements

Licensed platform operators are required to establish and implement adequate and appropriate AML/CTF policies, procedures and controls (**AML/CTF Systems**) to counter the money laundering and terrorist financing risks associated with cryptocurrencies' anonymity. Platform operators must also regularly review the effectiveness of their AML/CTF Systems and effect appropriate enhancements, taking into account any new SFC guidance and updates of the FATF Recommendations applicable to cryptocurrency-related activities including Recommendation 15 and its related interpretive note. Cryptocurrency tracking tools can also be used to trace transaction histories against a database of known addresses connected to criminal activities.

Prevention of Market Manipulation and Abusive Activities

Licensed platform operators are required to establish and implement written policies and controls for the proper surveillance of activities on its platform in order to identify, prevent and report any market manipulative or abusive trading activities. They must also adopt an effective market surveillance system and provide the SFC access to this system to perform its own surveillance. Policies should be established for the proper surveillance of platform activities to identify, prevent and report market manipulative or abusive trading practices or activities.

Accounting and Auditing Requirements

Licensed platform operators are required to exercise due skill, care and diligence in selecting and appointing their auditors.

Risk Management and Conflict of Interest Identification

Licensed trading platforms are required to have a risk management framework which enables them to identify, measure, monitor and manage the full range of risks arising from their businesses and operations. Clients should pre-fund their own accounts, as licensed platforms are prohibited from providing any financial accommodation for clients to acquire cryptocurrencies.

Licensed platforms are prohibited from engaging in proprietary trading or market-making activities on a proprietary basis. If a platform plans to use market-making services to enhance liquidity in its market, this must be done at arm's length and be provided by an independent external party using normal user access channels. A licensed platform operator must also have a policy governing employees' dealing in cryptocurrencies to eliminate, avoid, manage or disclose actual or potential conflicts of interests.

Cryptocurrencies for Trading

Licensed platform operators are prohibited from offering or trading cryptocurrencies that are crypto futures contracts or crypto derivatives.

Licensed platform operators need to set up a function responsible for establishing, implementing and enforcing the rules setting out the obligations of, and restrictions on, issuers of cryptocurrencies, and the criteria for a cryptocurrency to be included on and/or withdrawn from its platform.

The platform operator is also obliged to conduct reasonable due diligence prior to including a cryptocurrency on its platform and must ensure that the cryptocurrencies traded on its platform continue to satisfy all of the application criteria. Matters which must be considered include:

- i. the background of the management or development team of the issuer of the cryptocurrency;
- ii. the regulatory status of the cryptocurrency in each jurisdiction in which the platform operator provides trading services which includes whether the cryptocurrency can be traded under the SFO;
- iii. the supply, demand, maturity and liquidity of the cryptocurrency, its market capitalisation, average daily trading volumes, whether other platform operators trade the cryptocurrency in question, the availability of trading pairs and the jurisdictions where the cryptocurrency has been offered;
- iv. the marketing materials of the cryptocurrency which must not be misleading;
- v. the development and outcomes of any projects associated with a cryptocurrency should be included in the Whitepaper together with the major incidents associated with its history and development; and
- vi. in relation to cryptocurrencies which are "securities" under the SFO, the licensed platform operator should only include those that are: (i) asset-backed; (ii) approved by or registered with regulators in comparable jurisdictions (as agreed by the SFC from time to time); and (iii) have a track record of 12 months or more since issue.

The operator of a virtual asset trading platform will typically be licensed by the SFC for Regulated Activities Type 1 (dealing in securities) and Type 7 (providing automated trading services). Once licensed, a platform operator will be required to

comply with all relevant regulatory requirements in relation to all its business (i.e. in relation to cryptocurrencies that are securities and those that are not). The SFC also requires that all virtual asset trading activities conducted by the platform operator and its group companies which are actively marketed to Hong Kong investors or are conducted in Hong Kong are carried out by a single legal entity licensed by the SFC. This includes all virtual assets trading activities on and off the platform and activities incidental to the trading activities.

3. FSTB PROPOSALS FOR A NEW LICENSING REGIME FOR VIRTUAL ASSET EXCHANGES UNDER THE AMLO

The FSTB published a consultation in November 2020 proposing a new licensing regime for virtual asset exchanges under the AMLO, which will require any person seeking to conduct the “regulated VA activity” of operating a virtual asset exchange in Hong Kong to obtain a VASP licence from the SFC, even if the exchange only trades virtual assets which are not securities. The proposed regime aims to implement the FATF requirement for jurisdictions to regulate virtual asset service providers (**VASPs**) for AML / CFT purposes and supervise their compliance, a requirement introduced in February 2019 with the revision of FATF’s standards. The application of the proposed regime will however be much narrower than the FATF’s definition of VASPs, which also covers businesses involved in transferring virtual assets, providing safekeeping and/or administrative services of virtual assets or instruments enabling control over virtual assets (including certain wallet providers) or providing financial services related to the offer or sale of virtual assets (e.g., ICOs). This is because the FSTB considers virtual asset exchanges to be the most prevalent and developed virtual asset activity in Hong Kong, therefore warranting the introduction of a tailored licensing regime, with the potential for expansion of the regime at a later date.

If the new licensing regime takes effect, virtual asset exchanges will have 180 days to obtain a VASP licence.

3.1 Scope of Regulated Activity of Operating a Virtual Asset Exchange

Definition of a Virtual Asset Exchange

A virtual asset exchange will be defined as any trading platform which is operated for the purpose of allowing an offer or invitation to be made to buy or sell any virtual asset in exchange for any money or any virtual asset (whether of the same or a different type) and which comes into custody, control, power or possession of, or over, any money or any virtual asset at any point in time during its course of business. This definition will require centralised virtual asset exchanges to be licensed, however peer-to-peer trading platforms (that is platforms that only provide a forum for buyers and sellers of virtual assets to post their bids, with or without automated matching mechanisms) are excluded from the definition, provided that the actual transaction is conducted outside the platform and the platform is not involved in the underlying transaction by coming into possession of any money or virtual asset at any time. Decentralised virtual asset exchanges should therefore fall outside the scope of the licensing regime.

Definition of Virtual Assets

The proposals will largely align the definition of virtual assets with FATF’s definition (i.e., digital representations of value that can be digitally traded, or transferred, and can be used for payment or investment purposes). The AMLO will define a virtual asset as a digital representation of value that: is expressed as a unit of account or a store of economic value; functions (or is intended to function) as a medium of exchange accepted by the public as payment for goods or services or for the discharge of a debt, or for investment purposes; and can be transferred, stored or traded electronically. The definition will therefore cover virtual assets which are not securities, such as Bitcoin and Ethereum. Stablecoins (i.e., virtual assets backed by assets) will also fall within the definition. Digital representations of fiat currencies (including CBDCs), financial assets already regulated under the SFO and closed-loop, limited purpose items that are non-transferable, non-exchangeable and non-fungible including air miles, credit card rewards, gift cards, customer loyalty programmes and gaming coins, will be excluded.

3.2 Virtual Asset Exchange Licensing Requirements

The FSTB is proposing that only Hong Kong-incorporated companies with a permanent place of business in Hong Kong will be eligible for licensing as a virtual asset exchange. So, natural persons and businesses without a separate legal personality (e.g., sole traders or partnerships) will not be licensed. Virtual asset exchanges that are incorporated offshore will also not be eligible for licensing under the new regime.

The FSTB also proposes to prohibit the active marketing of a regulated VA activity or similar activity (i.e., services associated with a virtual asset exchange), whether in Hong Kong or elsewhere, to the public in Hong Kong without a VASP licence. This provision is similar to section 115 of the SFO and, since the SFC will not license an offshore entity, will prevent an offshore virtual asset exchange from marketing its services to Hong Kong investors. An offshore exchange that wants to be able to market to Hong Kong investors will therefore need to establish a Hong Kong subsidiary which will need to be licensed as a VASP by the SFC.

Licensing applicants will be required to appoint at least two responsible officers who will be responsible for ensuring the firm’s compliance with the AML/CTF requirements and other regulatory requirements. As is the case for licensed corporations, all executive officers will need to be approved as responsible officers of a licensed virtual asset exchange.

The licensing applicant, its responsible officers and the ultimate owners of the corporate entity will need to satisfy a fit-and-proper test, which will assess the person’s experience and qualifications and require that they have not been convicted of any money laundering or terrorist financing offence or other offence involving dishonesty and are not the subject of any liquidation or bankruptcy proceedings. Any change to the responsible officers or ultimate owners will require the SFC’s prior approval, however the FSTB do not clarify who will be regarded as an “ultimate owner” of a virtual asset exchange for these purposes.

3.3 Obligations of Licensed Virtual Asset Exchanges

Licensed virtual asset exchanges will be required to observe the AML/CFT requirements under Schedule 2 to the AMLO, which prescribes certain requirements relating to customer due diligence and record-keeping.

The regulatory standards for virtual asset exchanges licensed under the AMLO will be essentially the same as those for exchanges licensed under the SFO regime to ensure a level playing field for all virtual asset exchanges. The SFC will be empowered to impose licensing conditions and other regulatory requirements and may vary them where appropriate. These will include:

- (i) restrictions on providing trading services to professional investors only, although the SFC may relax this position in the future as markets mature;
- (ii) a required minimum paid-up share capital requirement and, depending on the nature of business, a liquid asset requirement (to be set by the FSTB);
- (iii) licensed virtual asset exchanges will be required to have a proper corporate governance structure staffed by personnel with appropriate knowledge and experience;
- (iv) requirements relating to operating their virtual asset business in a prudent and sound manner and ensuring that client and public interests are not adversely affected;
- (v) putting in place appropriate risk management policies and procedures for managing money laundering and terrorist financing, cybersecurity and other related risk;
- (vi) ensuring the proper segregation of client assets and ensuring adequate policies and governance procedures are in place to ensure the proper management and custody of client assets;
- (vii) implementing and enforcing robust rules for the listing and trading of virtual assets on their platforms. In particular, they will need to perform all reasonable due diligence on virtual assets before listing them for trading;
- (viii) following specified auditing and disclosure requirements and publishing audited accounts;
- (ix) implementing written policies and controls for the proper surveillance of activities on a virtual asset exchange to identify, prevent and report any market manipulative or abusive trading activities; and
- (x) to avoid any conflicts of interest, licensed virtual asset exchanges will be prohibited from engaging in proprietary trading or market-making activities on a proprietary basis.

3.4 Proposed SFC Powers in Respect of Licensed Virtual Asset Exchanges

The SFC will be empowered to supervise the AML/CFT conduct of licensed virtual asset exchanges and to monitor, investigate and enforce their other obligations under the AMLO licensing regime. The SFC will also be given certain powers in relation to entering and inspecting premises and documents in order to investigate instances of non-compliance and will be empowered to impose administrative sanctions (including suspending or revoking a licence). The SFC will also be provided with intervention powers to impose restrictions and prohibitions on the operations of a licensed exchange and its associated entities in certain circumstances, for example where it is necessary to protect client assets.

The FSTB also propose to amend Part 6 of the AMLO in order to expand the scope of reviewable decisions of the AML/CFT Review Tribunal to cover appeals against future decisions made by the SFC in relation to implementing the VASP licensing and supervisory regime.

4. MANAGING MONEY LAUNDERING AND TERRORIST FINANCING RISKS ASSOCIATED WITH VIRTUAL ASSETS

As for AML/CFT legislation in Hong Kong, the AMLO currently only applies to financial institutions (including HKMA-authorized institutions (i.e. banks), SFC licensed corporations, licensed insurance companies, stored value facility issuers and money service operators) and “designated non-financial businesses and professions” (“**DNFBP**”) (professions such as lawyers, public accountants, estate agents, and trust and company services agents). All entities that are licensed or registered by the SFC to conduct regulated activities are thus subject to the AML and CTF obligations of the AMLO.

The FSTB’s proposals to create a new licensing regime for virtual asset exchanges under the AMLO, if adopted, will also require virtual asset exchanges licensed under the new regime to comply with AML and CTF obligations of the AMLO.

The Hong Kong Monetary Authority and the SFC have also reminded regulated bodies of the need to comply with the FATF’s latest recommendation.

In response to the FATF’s revised Recommendations, the HKMA published a notice on [16 December 2019](#)⁵⁵ (the “**HKMA FATF Notice**”). The purpose of the HKMA FATF Notice was to provide guidance to authorised financial institutions in relation to the revised FATF Recommendations.

The HKMA FATF Notice reminded authorised institutions that when they establish and maintain business relations with VASPs, appropriate risk assessments should be carried out to differentiate the risks of each VASP, recognising that there is no ‘one size fits all’ approach. The approach adopted by authorised institutions will depend on the nature of the relationship between the authorised institution and the VASP. As such, authorised institutions must undertake additional customer due-diligence measures, which includes the collection of sufficient information to adequately understand the nature of the VASPs business, determining from publicly available information whether or not the VASP is licensed or registered

⁵⁵ HKMA notice on Managing ML/TF risks associated with virtual assets (VAs) and virtual asset service providers. Available at: <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2019/20191216e2.pdf>

and subject to AML/CTF supervision, and assessing the AML/CTF controls of the VASP as appropriate. The HKMA FATF Notice explains that the extent of the customer due-diligence measures employed by the authorised institution should be commensurate with the assessed money laundering/terrorist financing risks of the VASP.

Before introducing new banking or investment products, authorised institutions should also undertake money laundering / terrorist financing risks assessments, take appropriate measures to manage and mitigate the identified risks in accordance with the applicable legal and regulatory requirements which includes the requirements set out in the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism.

APPROACHES TO VIRTUAL ASSET REGULATION

The Cambridge Centre for Alternative Finance (**CCAF**) identified four principal types of regulatory responses to virtual assets:

1. Application of existing regulation – this is the approach that many regulators have adopted, which involves applying existing laws and regulations to activities involving virtual assets by issuing regulatory guidance on how existing laws apply to those activities. Examples include Australia’s Information Sheet (INFO 225) on ICOs and cryptocurrency and Hong Kong’s Statement on Securities Token Offerings;
2. Retrofitted regulation – extending existing laws and regulations to cover activities involving virtual assets. According to a study by the CCAF, countries with a higher level of domestic crypto asset activity, typically take this approach.⁵⁶ Of course, retrofitting regulation has its drawbacks (mainly the fact that distributed ledger technology (**DLT**) compares so starkly to traditional, centralised systems) however, this approach is attractive to many jurisdictions seeing rapid development of crypto activity.
3. Bespoke regulation – a number of smaller jurisdictions have taken this approach by enacting new laws specifically to regulate virtual asset activities. An example is Malta’s Virtual Financial Assets Act. The CCAF study found that generally, the likes of Malta, Gibraltar and Luxembourg have been able to develop these bespoke crypto regimes due to their relative lack of crypto asset activity.⁵⁷
4. Bespoke regulatory regimes – establishing a distinct regulatory framework applicable to a type of activities (typically fintech activities), of which virtual asset activities are one type.

MAINLAND CHINA

China has imposed severe restrictions on cryptocurrencies. A ban on banks and payment institutions dealing in Bitcoin has been in effect since 2013. ICOs were

⁵⁶ <https://www.torca.io/blog/cryptoasset-compliance-in-the-uk-the-story-so-far>

⁵⁷ <https://www.torca.io/blog/cryptoasset-compliance-in-the-uk-the-story-so-far>

banned in September 2017 and all ICOs were ordered to cease immediately and money already raised had to be refunded to investors. The regulators declared ICOs to be an unauthorised illegal fundraising activity and stressed that virtual assets issued in ICOs do not have legal status equivalent to that of fiat currencies and should not be used and circulated in the market as currencies. The ban was then extended to security token offerings and airdrops in December 2018.

Before the crackdown, 80% of the world's cryptocurrency transactions and ICO financing took place in the PRC,⁵⁸ with ICOs in China raising at least 2.62 billion yuan (around US\$400 million).⁵⁹ This compares to the position in Hong Kong, where ICOs are not prohibited. The SFC determines their regulatory status on a case-by-case basis (depending on whether the ICO tokens constitute security tokens), with the SFC preventing only one ICO to date (Black Cell technology's ICO in 2018).

Crypto trading platforms are also banned through various prohibitions (for example, on exchanging fiat currency for virtual assets; buying or selling virtual assets; setting virtual asset prices and providing information and intermediary services in relation to virtual assets.) Meanwhile, in Hong Kong, crypto trading platforms can and do operate and may be licensed by the SFC if they trade at least cryptoasset which is a security. Subject to the FSTB's latest proposals being adopted, centralised crypto exchanges operating in Hong Kong will also be required to be licensed.

Online access to offshore ICOs and crypto exchanges has also been blocked in China and on 15 February 2019, China's internet regulator, the Cyberspace Administration of China, announced new regulations (which took effect on 15 February 2019) which apply to blockchain information service providers – broadly entities using blockchain technology to provide online information services to the public. The new regulations impose restrictions similar to those applying to China's mobile payment service providers and clamp down on blockchain anonymity with requirements for users to provide their real names and national ID card numbers or phone numbers when registering for a blockchain service. Blockchain service providers need to register with the government and are required to censor content “deemed to pose a threat to national security”. They must also keep a record of information published by users and disclose this information to the government. The new regulations appear to target the use of blockchain technology to bypass China's censorship of the internet following cases of individuals posting information on the Ethereum blockchain to escape censorship.

Bitcoin mining has not yet been banned in the PRC, although there were plans to, plans that were subsequently scrapped.⁶⁰ Despite this, China's miners account for around 72% of the average monthly bitcoin hashrate (that is the computing power dedicated to supporting the network).⁶¹ It is however becoming more challenging

⁵⁸ SCMP. “Central bank deputy governor: STO business “essentially an illegal financial activity in China”. 9 December 2018.

⁵⁹ CNBN. “China bans companies from raising money through ICOs, asks local regulators to inspect 60 major platforms”. 24 September 2017 <https://www.cnbc.com/2017/09/04/chinese-icos-china-bans-fundraising-through-initial-coin-offerings-report-says.html>

⁶⁰ <https://www.coindesk.com/chinese-agency-scrap-eliminate-bitcoin-mining-industry>

⁶¹ <https://www.coindesk.com/chinese-miners-struggle-to-pay-for-electricity>

for bitcoin miners to operate in China with a recent crackdown on OTC brokers.⁶² As a result, many have and are moving operations overseas and others are shutting down operations altogether.⁶³ By comparison, there are no specific regulations in relation to mining cryptocurrencies in Hong Kong and no guidance has been issued discouraging mining activities, although, depending on the scale and specifics of the mining operations, regulation that applies to other similar activities (such as data centres) may apply to mining.⁶⁴

Despite China's prohibitive and restrictive approach to cryptocurrencies, China has launched a digital currency project, known as the Digital Currency Electronic Payment (**DCEP**), or the "digital yuan", a CBDC controlled and issued by the People's Bank of China (**PBOC**). The digital yuan is essentially a digital version of the RMB to be used for everyday banking activities. It is currently on trial in four major cities and is said to simplify digital payments and interbank transfers. China is no stranger to mobile payment systems and is already to a large degree operating as a cashless society, which is in part due to Alibaba's Alipay and Tencent's WeChat Pay. With the introduction of the digital yuan, China will become the first country in the world to put a central bank digital currency into use. Hong Kong has been researching a central bank digital currency but the focus is on its potential for use in wholesale and cross-border payments.

JAPAN

Japan is one of the most progressive jurisdictions in terms of crypto regulation. Japan was the first country to recognise cryptocurrencies as a legal payment method in April 2017 (with the revision of its Payment Services Act (the **PSA**)) and Bitcoin is widely accepted by Japanese retailers and also for payment of utilities bills. For example, in 2019 the "Coincheck Gas" service was launched, which allows users to pay their gas bills using Bitcoin. "Coincheck Gas" was the result of a collaboration between the Coincheck virtual currency exchange and the energy company "E-net Systems". This collaboration enables users of Coincheck to pay for their gas bills using Bitcoin.

In Japan, cryptoassets are treated as assets which can constitute means of payment rather than as legal currencies. This compares to the position in Hong Kong where cryptocurrencies are also not treated as currencies (or legal tender), but virtual commodities. They are however often referred to as "virtual currencies".⁶⁵

Further, as early as 2017, the Japanese National Tax Agency released guidelines on tax treatment of virtual assets. In Hong Kong, the IRD issued DIPN 39 in March 2020 providing broad guidance and clarity on the tax treatment of virtual assets.

As for crypto exchanges, Japan's Financial Services Authority (the **FSA**) licenses and regulates virtual asset exchanges subjecting them to money laundering regulations. As crypto asset exchange services are broadly defined, other service providers engaging in crypto activities must also register with the FSA (including

⁶² <https://www.coindesk.com/chinese-miners-struggle-to-pay-for-electricity>

⁶³ <https://www.coindesk.com/chinese-miners-struggle-to-pay-for-electricity>

⁶⁴ <https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/hong-kong>

⁶⁵ <https://www.bitcoin.org.hk/hong-kong-bitcoin-regulation/>

crypto custodians).⁶⁶ Crypto asset exchange service providers must not engage in activities relating to security tokens as these activities are governed by the Financial Instruments and Exchange Act (**FIEA**) and additional licensing is required.⁶⁷

As of March 2020, there were 23 approved crypto exchanges in Japan (one being OKCoin, once one of China's "Big 3" crypto exchanges, which moved to the US following the 2017 ban).⁶⁸ A number of exchanges were licensed initially, however following the hack of Tokyo cryptocurrency exchange, Coincheck, in January 2018 (which saw almost US\$500 million in digital tokens stolen) the FSA tightened its screening of crypto exchanges and with the cost involved with licensing increasing, many firms withdrew their licensing applications and ultimately, no exchanges were licensed for a year.⁶⁹ One firm which withdraw its application was Payward Japan, which operates Kraken exchange. Kraken withdrew entirely from the Japanese market in 2018 as a result of the crackdown but recently re-entered and has since been awarded a licence.⁷⁰

Further to amendments to the FIEA, which took effect in May 2020, security tokens and ICO tokens are classified as electronically recorded transferable rights (**ERTRs**).⁷¹ As a result, they are not considered "crypto assets", which are regulated by the PSA. ETRTs are themselves classified as Type 1 Securities and licensing requirements therefore apply to the broker, issuers and ICO operators and ICOs must be handled by a licensed securities company. If the tokens offered do not represent investment contracts (i.e., in the case of utility tokens), the offering is regulated by the PSA.⁷² In this case, the issuer is required to register as a crypto asset exchange service provider (or can sell the tokens via a registered exchange).⁷³ This compares to the position in Hong Kong where ICOs involving tokens which are not securities are unregulated.

Another major change following the amendments to the PSA and FIEA taking effect in May 2020, is that crypto asset related derivative businesses are now regulated under the FIEA. Previously, the Japanese derivative regulations did not apply as crypto assets were not included in the definition of underlying assets to which the regulations apply.⁷⁴ As for Hong Kong, which is quite a dominant player in the crypto derivatives space, with most of the derivatives trading volume deriving from exchanges based in Hong Kong,⁷⁵ this area remains largely unregulated, however this may change if the FSTB proposals are adopted.

⁶⁶ <https://innovationlaw.jp/en/digital-assets-in-japan/>

⁶⁷ <https://innovationlaw.jp/en/digital-assets-in-japan/>

⁶⁸ <https://www.coindesk.com/crypto-exchange-okcoin-licensed-japan-fsa-institutional-investors>

⁶⁹ <https://www.coindesk.com/crypto-exchange-okcoin-licensed-japan-fsa-institutional-investors>

⁷⁰ <https://www.coindesk.com/kraken-relaunches-crypto-trading-in-japan-after-two-year-break>

⁷¹ <https://www.syгна.io/blog/japan-crypto-asset-regulation-financial-services-agency-changes-psa-fiea-may-2020/>

⁷² [https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2020/02/New-Regulations-for-Crypto-Assets-\(Virtual-Currencies\)-and-Initial-Coin-Offering%20-and-Security-Token-Offering-in-Japan.pdf.pdf](https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2020/02/New-Regulations-for-Crypto-Assets-(Virtual-Currencies)-and-Initial-Coin-Offering%20-and-Security-Token-Offering-in-Japan.pdf.pdf)

⁷³ <https://innovationlaw.jp/en/digital-assets-in-japan/>

⁷⁴ <https://www.klgates.com/Japans-New-Crypto-Regulation-2019-Amendments-to-Payment-Services-Act-and-Financial-Instruments-and-Exchange-Act-of-Japan-11-26-2019>

⁷⁵ <https://coincodex.com/article/10000/hong-kong-regulator-to-clamp-down-on-unregulated-crypto-futures-exchanges/>

UNITED STATES

The regulatory position in the US is complicated and cryptocurrency-related activities potentially fall within the jurisdiction of a number of US federal regulators - the Securities and Exchange Commission (the **SEC**) may regulate them as securities, the Commodity Futures Trading Commission (the **CFTC**) classifies them as commodities, and the Financial Crimes Enforcement Network (**FinCEN**) treats them as currency. Crypto assets can also be regulated as “virtual currencies” such that the guidelines of FinCEN apply to “administrators” and “exchangers” which need to be registered with FinCEN as a money service business and comply with regulations aimed at countering money laundering and terrorist financing. FinCEN has brought criminal and civil enforcement actions against cryptocurrency businesses for failure to register and non-compliance with anti-money laundering procedures.

State regulators also regulate various activities, for example, New York’s BitLicence. New York State has been active in terms of regulation and requires any business engaging in the transmission, trading, custody or issue of a virtual currency to obtain a BitLicence. Licensees have to satisfy requirements including a minimum capital requirement and anti-money laundering and know-your client obligations. As at June 2020, the State of New York had issued 25 BitLicences, including to Hong Kong’s XAPO Holdings.

As a result, the jurisdiction of US agencies frequently overlaps and this has led to allegations of excessive and unclear regulation, which is stifling the development of virtual asset technologies.

On 16 November 2018, the SEC issued a Statement on Digital Asset Securities Issuance and Trading⁷⁶ setting out its views on three principal areas relating to digital assets: ICOs, investment vehicles investing in digital asset securities and trading of digital assets.

ICOs

The SEC has repeatedly stated that virtual assets may qualify as “securities” and that ICOs thus need to comply with US securities laws, in particular the 1933 Securities Act. This is comparable to Hong Kong’s approach which regulates ICOs where the virtual assets constitute securities under the SFO). Accordingly, there are registration requirements (requiring the registration of the ICO as a public securities offering), although exemptions are available under Regulation A+ and D. Blockstack was the first company to conduct an ICO under the Regulation A+ exemption in September 2019.

The SEC has taken enforcement actions against a number of ICOs as unregistered securities offerings. Examples include SimplyVital Inc., ICOBox, and the original landmark case involving the DAO tokens, which we are going to look at in more detail in a moment. However, in spite of SEC statements suggesting that all ICOs are securities offerings, the US enforcement actions based on securities law violations have involved cases where explicit statements were made that token

⁷⁶ <https://www.sec.gov/news/public-statement/digital-asset-securities-issuance-and-trading>.

holders could expect to receive a profit. This raises the question of whether it was the explicit promotion of the ICOs as something that would increase in value that resulted in them being targeted by the SEC, rather than their “utility token” features. Without the express statements suggesting the ability to make a profit from the tokens, the ICOs may not have amounted to a securities offering. Comparably, in Hong Kong, the SFC has halted only one ICO - the ICO of Black Cell in March 2018 on the basis that making the tokens available to Hong Kong investors constituted “potential unauthorised promotional activities and unlicensed regulated activities” and that the sale of the tokens in the proposed manner may constitute a CIS. In that case, it was however fairly clear that the tokens were “securities” since they were redeemable for Black Cell shares.

DAO Tokens & the Howey Test

In July 2017, the SEC released a report determining that “DAO Tokens” offered and sold by a “virtual” organisation called the DAO were “securities” under the Securities Act of 1933 and the Securities Exchange Act of 1934. DAO Tokens were offered in exchange for Ether (**ETH**) and the ETH raised would be used to fund projects.

Under the Howey Test, an investment contract (which is a security) 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.

The DAO met the all the requirements of the Howey test. Purchasers of DAO were found to have invested with a reasonable expectation that they would receive a return in the form of a share of the profits from projects funded by the DAO. The promotional materials informed investors that they would share in the profits of the projects funded by their investment. Token holders could also monetise their investment by reselling DAO tokens in the secondary market. The profits were also found to be “derived from the entrepreneurial or managerial efforts of others” as profits for investors were generated by the managerial efforts of Slock.it and its co-founders in putting forward project proposals. The DAO ICO was however unusual in that it was essentially a tokenised fund and thus fell squarely within the definition of a security.

The regulatory position is less clear in relation to “utility tokens” which proliferated in the wake of the DAO report. Subsequent statements from SEC officials suggested that all ICOs are securities offerings (save for Bitcoin and Ether which are regarded as commodities, as is the position in Hong Kong). However, the SEC have indicated that 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”.

The key feature of a utility token is that rather than entitling holders to a share of the profits from investments, they typically provide a right of access to a specific product or service provided or to be provided by a DLT platform. However, as became clear in SEC enforcement actions, merely calling something a “utility token” does not mean it is not a security if it is in fact marketed as an investment products, as was determined in the enforcement action relating to the Munchee ICO.

Similarly, in Hong Kong, the SFC 2018 statement appeared to recognise that “utility tokens” are not generally “securities” under the SFO. However there is no legal definition of a “utility token” in Hong Kong. Nor is there any Hong Kong case law or guidance from the regulators on the characteristics of an ICO token that might cause it to be considered a security.

SEC Action against Ripple

One of the most high profile recent regulatory actions is the US SEC’s December 2020 action against Ripple and two of its senior executives for allegedly conducting a US\$1.3 billion unregistered securities offering of XRP tokens, the world’s fourth largest cryptocurrency by market cap., which were offered to investors in the US and worldwide in 2013 allegedly in breach of the US Securities Act of 1933. Ripple also distributed billions of XRP in exchange for non-cash consideration such as labour and market-making services. Following the announcement, Coinbase, Bitstamp, OK Coin and Hong Kong-based OSL suspended trading in XRP, with XRP subsequently falling by 31%.⁷⁷

The SEC complaint alleges that XRP is an “investment contract” within the Howey Test and is thus a security subject to the registration requirements of the Securities Act. It notes that the “defendants understood and acknowledged in non-public communications that the principal reason for anyone to buy XRP was to speculate on it as an investment.” In particular, in publicly offering and selling XRP, Ripple allegedly promised to undertake significant entrepreneurial and managerial efforts, including to create a liquid market for XRP, which would in turn increase demand for XRP and therefore its price.

Ripple has disputed the allegation that XRP is an investment contract and has described the SEC’s action as an “assault on crypto at large”. Ripple’s main arguments are that:

- XRP is a currency, similar to Bitcoin and Ether, which the SEC has determined are not securities; and
- XRP has a fully functional ecosystem and a real use case as a bridge currency that does not rely on Ripple’s efforts for its functionality or price – it therefore differs from earlier ICO cases which did not have developed ecosystems or an established utility for the digital assets which were sold to purchasers based on promises of profits and ongoing efforts.

A commentator on Forbes noted that the long-term effect of the SEC’s action may be a broader shaking out and differentiation between ICO products and digital tokens resembling the analogue governance models of before versus truly decentralised modes of governance. It could also lead to businesses avoiding the US legal system. Ripple has reportedly been looking for new headquarters outside the US due to the lack of regulatory clarity. Countries under consideration include Japan and Singapore.

⁷⁷ <https://markets.businessinsider.com/currencies/news/xrp-token-falls-after-platform-coinbase-says-to-halt-trading-2020-12-1029923012>

Other recent (and high-profile) enforcement actions include those brought against Kik and Telegram. In both cases, the SEC alleged that Kik and Telegram tokens were securities within the meaning of US securities laws, with the token offerings therefore being unregistered securities offerings. Both Kik and Telegram structured their offerings as SAFTs – Simple Agreements for Future Tokens, a concept which attempted to skirt US securities laws by distributing tokens after the launch of the blockchain network (hence the tokens would be considered utility tokens).

In the case of Telegram, the US\$1.7 billion token sale was determined to be an unregistered security offering, despite Telegram’s argument that the tokens (Grams) were currency. In agreeing with the SEC that the tokens were securities, the Court determined that there was a common enterprise and that a reasonable Initial Purchaser would have purchased Grams with investment intent and an *expectation of profit* (citing the testimonies of purchasers and various other facts). It was also found that this expectation was based on the essential entrepreneurial and managerial efforts of Telegram. This finding was based on various facts including that Grams did not exist at the time of the sales, purchasers provided capital to fund the development of the TON blockchain in exchange for the future delivery of Grams, expecting to resell them for a profit, and that the offering materials emphasised Telegram’s commitment to developing the project. The Court further found that Telegram failed to demonstrate that it was exempt from the registration requirements under Regulation D (which provides an exemption for registration of securities offered in private sales to accredited investors). This was based on the finding that Telegram did not intend Grams to remain with the initial purchasers, but intended them to reach the public via post-launch resales by initial purchasers (who the Court found were underwriters).

The Kik decision followed, with the Court largely adopting the same reasoning. The Kik case differs from Telegram’s though as Kik’s tokens (**KIN**) were offered in both a pre-sale to a limited number of accredited investors and a public sale (which Kik argued were two distinct transactions). The Court ultimately concluded that both transactions were integrated and constituted an unregistered securities offering based on, in short, the fact that Kik pooled the proceeds from its sales of Kin in an effort to create an infrastructure for Kin, and thus boost the value of the investment.

Investment Vehicles Investing in Digital Asset Securities

The SEC November 2018 statement also set out the SEC’s views on funds that invest in digital asset securities, stating that funds investing in crypto assets that are securities must be registered under the Investment Company Act and that the managers of the investment vehicles must observe the registration, regulatory and fiduciary obligations under the Investment Advisers Act.⁷⁸ The first “crypto fund” to register was the Arca US Treasury Fund in July 2020, a fund which invests in short-term treasury securities, with investors holding their shares in ArCoins, an ERC-1404 token.⁷⁹

⁷⁸ <https://www.sec.gov/news/public-statement/digital-asset-securities-issuance-and-trading>

⁷⁹ <https://www.theblockcrypto.com/post/70460/arca-sec-registration-ethereum-digital-share>

This approach is broadly comparable to Hong Kong’s approach where managers of funds investing 10% or more of their GAV in virtual assets are required to be registered for Type 9, however unlike the US, this applies whether or not the virtual assets are securities or futures contracts. Licensing requirements also apply to the distributors of virtual asset funds which require a Type 1 licence.

Trading Digital Asset Securities

The SEC statement also addressed the trading of digital asset securities, outlining that a trading platform which offers trading of crypto assets which are “securities” and operates as an “exchange” as defined under federal securities laws 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 Financial Industry Regulatory Authority (**FINRA**). FINRA has reportedly only approved a few of the many crypto broker-dealer applications it has received. This is comparable to Hong Kong’s current approach, with the SFC licensing exchanges which trade at least one security token.

Crypto trading platforms are also regulated by other agencies at both federal and state levels, for example a crypto exchange may be subject to regulation by the CFTC if it permits certain regulated commodities transactions or swaps in crypto-assets. FinCEN also requires businesses involved in buying cryptocurrency from or selling it to customers or transferring cryptocurrency on behalf of customers to register with FinCEN as money services businesses.⁸⁰

The latest statement from the SEC came on 23 December 2020 when a statement was issued regarding the custody of digital asset securities by broker-dealers and compliance with Rule 15c3-3 (the **Customer Protection Rule**).⁸¹ The SEC has long questioned whether digital asset custodians can effectively comply with the Customer Protection Rule and broker-dealer custody was therefore prohibited.⁸² The statement is therefore a huge breakthrough as it provides a path for crypto-focused broker-dealers (operating in certain 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. The statement is effective for a period of five years while the SEC determines how best to regulate this area.

Crypto Wallets

New rules for crypto wallets were proposed by the FinCEN on 18 December 2020). Following President Biden taking office in mid-January, the proposals were frozen (effected by a general freeze placed on all FinCEN rule making pending review). It is understood that the freeze is not so much aimed at halting the substance of the

⁸⁰ <https://www.nortonrosefulbright.com/en-us/knowledge/publications/e383ade6/cryptocurrency-exchanges-and-custody-providers-international-regulatory-developments#section11>

⁸¹ <https://www.sec.gov/news/press-release/2020-340>

⁸² <https://www.clearygottlieb.com/news-and-insights/publication-listing/sec-issues-statement-and-request-for-comment-regarding-broker-dealer-custody>

rules but ensuring that Biden's appointees have sufficient time to review the rules, with the freeze being effective for at least 60 days from 20 January 2021. The crypto market does however seem optimistic about a clear regulatory framework under the newly elected president.

The new rules are aimed at addressing AML "gaps" in digital asset transactions by imposing obligations on Virtual Asset Service Providers (**VASPs**). 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 currency transaction report (**CTR**). This would broaden the current AML regime, which only sees record-keeping and reporting requirements imposed on VASP-to-VASP transactions. While different in scope, the focus on tightening AML regulation is also in focus in Hong Kong, which has recently proposed amendments to the AMLO to subject virtual asset exchanges which are not licensed under the SFO to the AML requirements in Schedule 2 of the AMLO.

Criticisms have been voiced by various parties, including eight congress members who sent a letter to the US Treasury Secretary expressing their concerns. It has been argued that VASPs will face practical difficulties obtaining the required information and that it will adversely impact the effectiveness of existing AML regulation,⁸³ or may simply not tackle the very risks they are seeking to tackle. For example, the new rules may easily be evaded by breaking transactions up into smaller amounts.⁸⁴ Others went so far as to suggest that the proposed rules would put a brake on development of the industry in the US completely.⁸⁵

This proposal goes further than the FATF Travel Rule (which we discussed in an earlier webinar) which imposes requirements in relation to the collection, disclosure and transfer of beneficiary information when a VASP is transacting with another VASP.

SEC Statement on "Framework for 'Investment Contract' Analysis of Digital Assets

As outlined above, there were a number of SEC enforcement actions involving ICOs which were found to be public offerings of securities conducted in breach of the US Securities Act 1933 since they were neither registered with the SFC nor able to rely on an exemption from the registration requirement. In April 2019, the SEC then issued a Statement on "Framework for 'Investment Contract' Analysis of Digital Assets providing guidance on when the offering and sale of a virtual asset will be considered to be an investment contract, and therefore a security. The framework applies the Howey Test (a test to determine whether certain transactions are "investment contracts") which focuses not only on the form and terms of the virtual asset, but also the surrounding circumstances and the manner of offering, selling and reselling. This is similar to the approach in Hong Kong, where the regulatory

⁸³ <https://www.coindesk.com/fincen-rule-crypto-wallets-could-be-ineffective-says-elliptic>

⁸⁴ <https://www.cpomagazine.com/data-privacy/proposed-new-fincen-rules-for-crypto-wallets-raise-privacy-concerns-larger-transactions-would-no-longer-be-anonymous/>

⁸⁵ <https://en.cryptonominist.ch/2021/01/21/joe-biden-freezes-regulation-of-crypto-wallets/>

treatment of ICOs is also determined on a case-by-case basis depending on an analysis of whether cryptocurrencies are regarded as securities under the SFO. However the issue of whether a cryptocurrency is a “security” has not yet come before the Hong Kong courts.

The most problematic of the Howey test’s three requirements is usually the “reasonable expectation of profits derived from the efforts of others” prong. This gives rise to three main inquiries.

- i. whether (a) a purchaser relies on the efforts of others, in particular the efforts of an active participant (**AP**) such as a promoter or other third party; and (b) whether those efforts are “undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise”.

Where the following factors are present, the more likely it is that a virtual asset purchaser relies on the efforts of others:

- a. the active participant is responsible for the development, improvement or enhancement, operation, or promotion of the network. If the network or virtual asset is still in development or not fully functional at the time of the offer or sale, purchasers would reasonably expect an active participant to further develop the functionality of the network or virtual asset;
 - b. essential tasks or responsibilities will be performed or are expected to be performed by an active participant;
 - c. the active participant supports or creates a market for, or the price of, the virtual asset;
 - d. the active participant plays a leading or central role in decision making or judgement exercising concerning the network or characteristics or rights of the virtual assets;
 - e. purchasers reasonably expect the active participant to undertake efforts to promote its own interests and enhance the value of the network or virtual asset.
- ii. reasonable expectation of profits - profits can include capital appreciation resulting from the development of the initial investment or business enterprise or a participation in earnings resulting from the use of purchasers’ funds.

Examples of characteristics giving rise to a reasonable expectation of profits include (among others):

- a. rights for holders of the virtual asset to share in the enterprise’s income or profit or to realise gain from capital appreciation of the virtual asset;
 - the opportunity may result from appreciation in the value of the virtual asset that comes, at least partly, from the operation,

- improvement or other positive developments in the network, particularly if there is a secondary market that enables virtual asset holders to realise a gain on reselling their virtual assets;
- b. present or future transferability or tradability of the virtual asset on a secondary market or platform;
 - c. purchasers' reasonable expectation that an active participant's efforts will lead to the virtual asset's capital appreciation and the realisation of a return;
 - d. the virtual asset is offered broadly to potential purchasers rather than being targeted at expected users of the goods or services or those with a need for the network's functionality;
 - e. there is little correlation between the virtual asset's purchase/offering price and the market price of the goods or services that can be acquired in exchange for the virtual asset;
 - f. the virtual asset is marketed in a way that indicates that the virtual asset is an investment or that the holders will be investors or that the proceeds from the sale of the virtual asset will be used to develop the network or virtual asset; and
 - g. marketing the virtual asset in a way that emphasises the potential appreciation in the value of the virtual asset or the potential profitability of the network or the availability of a market for trading the virtual asset, particularly where the active participant promises to create or support a trading market for the virtual asset.
- iii. the transaction's economic reality and whether the virtual assets are offered and sold for use by the purchaser. The Howey test is unlikely to be met where the following factors are present:
- a. the distributed ledger network and virtual asset are fully developed and operational;
 - b. the virtual asset can be used immediately for its intended functionality on the network;
 - c. the virtual asset's design meets the needs of users and does not encourage speculation as to its value or the network's development;
 - d. the ability of a virtual asset (which is proposed to be a virtual currency) to be used to make payments in different contexts or to act as a substitute for real currency;
 - e. the ability of the virtual asset to be redeemed within a developed network or platform for the goods or services.

The SEC guidance was released in conjunction with a no-action letter which was sent to Turnkey Jet, Inc. in April 2019 by FinHub’s Chief Legal Advisor agreeing that the tokens used by the business travel start-up were not securities. The reasons given were that (a) the funds raised through token sales would not be used to develop the TKJ Platform, Network or App, all of which would be fully developed and operational by the time the Tokens were sold; (b) the Tokens had an immediate use at the time of the token sale; (c) the Token price was fixed at one USD; (d) the Tokens could only be used for air charter services (e) repurchases would only be made at a discount to the Token price; (e) Turnkey Jet marketed the Tokens in a manner emphasizing their functionality rather than potential increase in value; and (f) the Tokens were transferrable only to TKJ wallets and not to wallets outside the network. According to FinHub’s division head, this decision was “easy” to reach as the “the tokens were clearly not intended to be securities”.⁸⁶

The restrictions outlined in the no-action letter mean that it is unlikely to be of benefit to most ICO issues, i.e. those where the funds are used to develop the network and the tokens only have a future use. Another company whose ICO fell foul of US securities laws is ShipChain which was fined US\$2.05 million in December 2020 for an ICO conducted in 2017-2018.⁸⁷

In Hong Kong, there have been two statements issued by the SFC relating to STOs (the March 2019 statement on security token offerings) and ICOs (the September 2017 statement on initial coin offerings). However, these are far less detailed than the US SEC’s statement and, except for virtual assets which are essentially digital version of traditional securities (shares, debentures or interests in a fund) provide no real guidance on the circumstances which are likely to make a virtual asset a security. Although the SFC has given general warning statements about ICOs possibly being regarded as securities offerings, it has not specified the particular features which would bring an ICO within the definition of a “security”.

SEC Joint Statement on Activities Involving Digital Assets

In October 2019, the U.S. Commodity Futures Trading Commission (the **CFTC**), the FinCEN and the SEC issued a joint statement to remind persons engaged in activities involving digital assets of their anti-money laundering and counter terrorist financing obligations under the Bank Secrecy Act.

The Bank Secrecy Act (**BSA**) applies to “financial institutions” such as futures commission merchants and introducing brokers who are required to register with the CFTC; money service businesses as defined by the FinCEN; and broker-dealers and mutual funds obliged to register with the SEC. In the case of financial institutions subject to the BSA, the AML/CFT obligations extend to digital asset activities.

In the US, where a person falls within the definition of a “financial institution,” that person’s AML/CFT obligations under the Bank Secrecy Act will be overseen by

⁸⁶ <https://www.theracetothetbottom.org/rttb/2019/8/31/sec-releases-framework-for-investment-contract-analysis-for-cryptocurrencies>

⁸⁷ <https://blockchain.bakermckenzie.com/2020/12/28/shipchain-is-the-latest-sec-ico-casualty/#page=1>

either the U.S. CFTC, the FinCEN, or the SEC depending on the activities carried out by the “financial institution.” For example, the AML/CFT activities of a money services business will be overseen by the FinCEN while the AML/CFT activities of a futures commission merchant will be overseen by the Commodity Futures Trading Commission, the Financial Crimes Enforcement Commission and the National Futures Association.

For those who are not regulated (“**unregulated individuals and entities**”), the digital assets must be carefully analysed in order to assess whether the digital assets are regulated financial assets and whether the digital asset activities would cause them to meet the definition of a financial institution under the BSA (i.e. brokers who do not typically deal with transactions in securities, need to carefully analyse whether the digital assets they transact with are considered securities). The SEC outlined in the joint statement that it is ultimately the facts and circumstances underlying the asset, activity or service, including its economic reality and use, that determines the general categorisation of an asset, the regulatory treatment of the activity and whether the persons involved are financial institutions for the purposes of the Bank Secrecy Act.

Among the AML/CFT obligations which the relevant entities are required to meet is the requirement to establish and implement an effective AML program and record keeping and reporting requirements, including suspicious activity reporting.

The Joint Statement notes that a key factor used to determine whether and how a person must register with the CFTC, FinCEN or the SEC is the nature of the digital asset-related activities that a person engages in. For example, certain “commodity” related activities may trigger registration and other obligations under the Commodity Exchange Act while other activities which involve a “security” may trigger registration and other obligations under the federal securities laws of the U.S.

Bitcoin ETFs

To date, the SEC has rejected all cryptocurrency ETF applications,⁸⁸ citing concerns relating to market manipulation, price volatility, hacking, and custody.

Bitwise would have been the first ever Bitcoin ETF had it been approved by the SEC. However, early last year, Bitwise Asset Management withdrew its application with the SEC for its proposed Bitcoin ETF. One of the biggest obstacles faced by Bitwise was the problem of market manipulation. Bitwise went to great lengths to address the SEC’s concern over market manipulation arguing that the volume data reported by virtual asset exchanges is inaccurate and actual volume is far lower than reported volume; the nature of bitcoin makes it resistant to manipulation since Bitcoin’s price is set on an open market with a global price and the fractured market provides an obstacle to manipulation to the extent there is no central market. Bitwise also emphasised that concerns regarding custody can be dealt with using Cold Storage which involves the creation of private keys on

⁸⁸ <https://www.thinkadvisor.com/2021/01/04/skybridge-capital-launches-bitcoin-fund-vaneck-tries-again-for-a-bitcoin-etf/>

devices not connected to internet and offline storage – pointing out that none of the Bitcoin hackings involved cold storage and further pointed to the existence of regulated, insured third party custodians. Nonetheless, the SEC rejected Bitwise’s application, although the SEC did say that it was going to review the rejected application. Despite this, Bitwise Asset Management still withdrew its application but stated that they remain committed to developing a bitcoin exchange traded product.⁸⁹

Following the recent price surges in Bitcoin, there has been renewed interest in Bitcoin ETFs. On 30 December 2020, VanEck filed an application with the SEC for the VanEck Bitcoin Trust which would invest in bitcoin.⁹⁰ This is Van Eck’s third application to date, with the last proposal being a bitcoin futures ETF.⁹¹ On 22 January 2021, Valkyrie Digital Assets, a crypto subsidiary of Valkyrie Investments, then filed an application with the SEC for a Bitcoin ETF. Valkyrie would trade on NYSE Arca and Xapo would custody the Bitcoin, according to the proposal.⁹² While the likelihood of the applications being accepted are unclear, it is evident that the environment is now more favourable given the recent growth in the bitcoin market, increased institutional interest and confirmation from the Office of the Comptroller of Currency in July 2020 that federally chartered banks can provide custody services for crypto assets.⁹³ Additionally, there has been a change in administration at the SEC and in the White House. Gary Gensler has been nominated as the next SEC chair – Gensler is known to be more “crypto-friendly” – and this has imparted hope with some stating that a US Bitcoin ETF is expected in 2021 if Gensler is confirmed as Chair.⁹⁴

In Hong Kong, while distinct from an ETF, the SFC approved Hong Kong’s first-ever bitcoin index fund (designed for institutional investors) in April 2020.⁹⁵ The fund was launched by Arrano Capital, the blockchain arm of Venture Smart Asia, and is aiming for a target first-year size of US\$100 million (or Hk\$780 million).⁹⁶

Virtual Asset Exchanges

Jurisdictions are now required to apply relevant measures under the FATF Recommendations to virtual assets and VASPs. Recommendation 15 explicitly sets out that countries should ensure VASPs are regulated for AML/CFT purposes, and licensed or registered and subject to effective systems of monitoring to ensure compliance with the FATF Recommendations. This recommendation is aimed at preventing the misuse of virtual assets for ML/TF purposes.

⁸⁹ <https://www.coindesk.com/bitwise-withdraws-bitcoin-etf-application-with-the-sec>

⁹⁰ https://www.sec.gov/Archives/edgar/data/1838028/000093041320002664/c100811_s1.htm#c100811_creation1

⁹¹ <https://www.thestreet.com/etffocus/market-intelligence/vaneck-launch-bitcoin-etf-again>

⁹² <https://decrypt.co/55141/valkyrie-digital-assets-becomes-latest-company-to-file-for-bitcoin-etf>

⁹³ <https://www.thinkadvisor.com/2021/01/04/skybridge-capital-launches-bitcoin-fund-vaneck-tries-again-for-a-bitcoin-etf/>

⁹⁴ <https://news.bitcoin.com/crypto-etf-race-heats-up-in-2021-valkyrie-bitcoin-trust-files-to-list-shares-on-nyse/>

⁹⁵ <https://www.coindesk.com/hong-kongs-first-regulator-approved-bitcoin-fund-targets-100m-raise>

⁹⁶ [https://www.thestandard.com.hk/section-news/section/2/218298/HK-first-approved-crypto-fund-eyes-US\\$100m](https://www.thestandard.com.hk/section-news/section/2/218298/HK-first-approved-crypto-fund-eyes-US$100m)

The FATF undertook a review after it issued its new guidelines in June 2019 with respect to crypto currency exchanges. The FATF Report on the US found that the US was largely compliant with the FATF Recommendations, stating that:

- i. most of the convertible virtual currency exchanges, administrators and other similar entities are regulated in the US as money transmitters or money service businesses under the Bank Secrecy Act and as such, these entities have to implement AML/CFT programmes;
- ii. banks and other persons registered with or regulated by the SEC and CFTC, that engage in transactions denominated in value that substitutes for currency will be subject to the Bank Secrecy Act regulations; and
- iii. money service businesses must register with FinCen and renew every two years. In addition, money service businesses must be licensed at the state level. This position differs from Hong Kong where crypto exchanges will currently only be licensed under the Securities and Futures Ordinance where they trade virtual assets that are “securities” or “futures contracts”. These exchanges are subject to the AML and CFT obligations set out in the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (**AMLO**). Exchanges which trade virtual assets that are not securities will however be required to be licensed and comply with AML and CFT obligations if the FSTB’s November 2020 proposals for these exchanges to be licensed under the AMLO are implemented. Crypto exchanges cannot be licensed as money service operators in Hong Kong.

Ultimately, the FATF noted that the US has met most of the new criteria of Recommendation 15 and that US authorities understand and are aware of the ML/TF risks relating to virtual assets. It considered that the five classes of VASPs were covered under a combination of various pieces of US legislation. However, the FATF found that the definition of VASP does not explicitly include all VASPs solely incorporated in the US but not performing any activity relating to US persons or having a US nexus.⁹⁷ As for Hong Kong, a new licensing regime for virtual assets exchanges has been proposed under the AMLO, a regime which aims to implement FATF recommendation 15 in relation to virtual asset exchanges. However, Hong Kong’s proposals are noticeably narrower than FATF’s requirements as they will not cover other categories of VASPs included in the FATF’s definition, such as businesses which provide crypto custody services without operating a crypto exchange platform.

US State Legislation

There is also regulation at the state level in the US. Each of the US states has its own State securities and financial services regulator and many have adopted regulations in relation to crypto currencies. New York has been the most active in terms of regulation, requiring any person (whether an individual or a company) engaging in Virtual Currency Business Activity to obtain a BitLicense. Virtual

⁹⁷ <https://www.fatf-gafi.org/media/fatf/documents/reports/fur/Follow-Up-Report-United-States-March-2020.pdf>

Currency Business Activity can fall into one of five types of activities involving New York or New Yorkers:

1. receiving virtual currency for transmission or transmitting virtual currency;
2. storing, holding, or maintaining custody or control of virtual currency on behalf of others;
3. buying and selling virtual currency as a customer business;
4. performing exchange services as a customer business; or
5. controlling, administering, or issuing a virtual currency.

In the State of New York, virtual currency is defined as: *“any type of digital unit that is used as a medium of exchange or a form of digitally stored value”* and is *“broadly construed to include digital units of exchange that: (i) have a centralised repository or administrator; (ii) are decentralised and have no centralised repository or administrator; or (iii) may be created or obtained by computing or manufacturing effort.”*

This definition specifically excludes digital units that (i) are used solely within online gaming platforms, (ii) have no market or application outside of those gaming platforms, (iii) cannot be converted into, or redeemed for, fiat currency or virtual currency and (iv) may or may not be redeemable for real-world goods, services, discounts, or purchases. It further excludes digital units as part of prepaid cards and digital units that can be redeemed for goods, services, discounts, or purchases as part of a customer reward program with the issuer but cannot be converted into, or redeemed for, fiat currency or virtual currency. This is broadly comparable to Hong Kong’s definition of virtual assets.

Licensees are also required to satisfy certain compliance requirements including a minimum capital requirement and anti-money laundering and know-your client obligations. Entities that hold virtual currencies for third parties must hold them on trust with an approved custodian. Depending on their activities, entities holding a Bitlicense may also be required to obtain a New York money transmission licence.

As of 19 June 2020, the State of New York had 25 regulated entities, including Hong Kong-based XAPO Holdings, which was granted a Bitlicense in June 2018.

The Bitlicense has been controversial and a number of crypto businesses left the state citing overly burdensome disclosure requirements and regulatory requirements. This sentiment compares to the current regulatory requirements for the licensing of trading platforms and exchanges in Hong Kong which have also been viewed as excessively burdensome and the first licence for a crypto exchange was only granted in December 2020.

It is also important to note that legislation at the state level in the US differs from state to state which means that businesses with customers in multiple states have to comply with a number of inconsistent, and often burdensome, state money transmission laws. Further, since all virtual assets are treated as currency, the laws

potentially apply to all issuers of tokens that have value, and anyone facilitating trading in them.⁹⁸

Proposed Cryptocurrency Act 2020

The Cryptocurrency Act of 2020 was introduced in Congress in March 2020. The aim of the Act is to clarify which federal agencies regulate which type of crypto assets, and to require those agencies to clarify licensing conditions and registration requirements. To date, the only progress is a referral of the bill to the Committee on Financial Services and the Committee on Agriculture.⁹⁹ Media reports have suggested that this proposed Act should not be considered a serious legislative attempt as it lacks thorough understanding of the current legislative regime.

The bill defines “crypto-commodity,” “crypto-currency,” and “crypto-security,” proposing that the CFTC be the primary regulator of crypto-commodities, the FinCEN and the Comptroller of the Currency be the regulators of cryptocurrencies, and the SEC be the regulator of crypto-securities and “synthetic stablecoins.” The bill also proposes that FinCEN “shall issue rules to require each crypto-currency (including synthetic stablecoins) to allow for the tracing of transactions in the crypto-currency and persons engaging in such transactions in a manner similar to that required of financial institutions with respect to currency transactions.” Moreover, FinCEN “shall carry out audits of each reserve-backed stablecoin to ensure that each stablecoin is fully backed by currency issued by the United States or a foreign government.”

On the topic of stablecoins, the US President’s Working Group on Financial Markets issued a statement on key regulatory and supervisory issues relating to stablecoins on 23 December 2020 stating that stablecoin arrangements must comply with applicable US legal, regulatory and oversight requirements and emphasising that providers must meet all applicable AML/CFT obligations before products are brought to market.¹⁰⁰ As for the regulation of stablecoins in Hong Kong, they generally fall outside the scope of the SFC’s regulatory ambit, however the FSTB’s proposed definition of virtual assets specifically provides for the inclusion of stablecoins, so provided that the virtual asset business falls under the definition of VASP, the licensing regime will apply.

UNITED KINGDOM

The UK is a jurisdiction which has generally adopted a “wait-and-see” approach to the regulation of cryptocurrencies.

The UK Financial Conduct Authority’s (FCA) [Consultation Paper: Guidance on Cryptoassets](#) was released in January 2019 and final guidance on cryptoassets was

⁹⁸ C. R. Goforth. “US Law: Crypto is Money, Property, a Commodity, and a Security, all at the Same Time” available at <https://ssrn.com/abstract=3272975>.

⁹⁹ <https://www.congress.gov/bill/116th-congress/house-bill/6154/all-actions?q=%7B%22search%22%3A%5B%22crypto-currency+act%22%5D%7D&r=1&overview=closed&s=2#tabs>

¹⁰⁰ <https://home.treasury.gov/system/files/136/PWG-Stablecoin-Statement-12-23-2020-CLEAN.pdf>

published in its policy statement later that year (in July 2019) on the extent of FCA regulation of activities relating to virtual assets and providing much needed guidance to market participants. According to the UK Cryptoassets Taskforce report of October 2018 however, the number of UK firms carrying out virtual asset activities was (at the time) small relative to other jurisdictions.

Categorisation of Virtual Assets

A key aspect of the FCA guidance is its categorisation of virtual assets. The FCA identified three principal types of virtual assets, while stressing that these categorisations are neither mutually exclusive nor exhaustive.

E-money tokens – cryptocurrencies meeting the Electronic Money Regulations' (EMRs) definition of e-money, that is:

1. an electronically stored monetary value that represents a claim on the issuer;
2. issued on receipt of funds for the purpose of making payment transactions;
3. accepted by a person other than the issuer; and
4. not excluded by regulation 3 of the EMRs.

These tokens are subject to the Electronic Money Regulations and firms must ensure they have the correct permissions and follow the relevant rules and regulations.

Security tokens – tokens that provide rights and obligations similar to instruments (regulated under the UK's securities laws) (such as shares, debentures and collective investment schemes).

Unregulated tokens – encompassing any token that does not meet the definition of e-money tokens or security tokens. This includes utility tokens, and exchange tokens, which fall outside the scope of UK regulation. However, where an FCA authorised firm carried on activities in an unregulated cryptoasset, it is possible that some FCA rules (such as the Principles for Business and the individual conduct rules under the Senior Managers and Certification Regime (SMCR)) may apply to those unregulated activities in certain circumstances.

Cryptocurrencies are most likely to be regulated as shares, debt instruments, warrants, certificates representing securities, and units in collective investment schemes.

The FCA notes that virtual assets vary widely in terms of the rights they grant to holders and use, recognising that they can be used as a means of exchange. However, the UK does not regard virtual assets as a currency or money, as has been previously stated by the Bank of England and the G20 Finance Ministers and Central Bank Governors. In his 2018 speech "The future of money", Bank of England Governor, Mark Carney noted that cryptoassets are "too volatile to be a good store of value, they are not widely accepted as a means of exchange, and they are not

used as a unit of account". In Hong Kong, virtual assets are also not considered to be currency, but are virtual commodities.

Regulated Tokens

Regulated tokens, in particular security tokens, are tokens which provide rights and obligations similar to specified investments under the Regulated Activities Order (excluding e-money), such as shares, debentures or units in a collective investment scheme.

Whether or not a virtual asset is a Specified Investment depends on its particular characteristics, although the FCA has recognised that most cryptoassets are not specified investments.¹⁰¹

Factors indicative of a virtual asset being a Specified Investment (and thus regulated by the FCA), include, but are not limited to:

- i. the contractual rights and obligations the holder has by virtue of holding or owning the virtual asset;
- ii. any contractual right to profit-share (e.g. dividends), revenues, or other payment or benefit of any kind;
- iii. any contractual right to ownership in, or control of, the issuer or other relevant person (e.g. by way of voting rights);
- iv. the language used in relevant documentation (e.g. the term 'whitepaper') that suggests the virtual assets are intended to function as an investment;
- v. whether the virtual assets are transferable and tradeable on virtual asset exchanges or any other type of exchange or market;
- vi. a direct flow of payment from the issuer or other relevant party to holders of virtual assets may be an indicator that the virtual asset is a security, although an indirect flow of payment (such as profits or payments derived exclusively from the secondary market) would not necessarily indicate the contrary. If the flow of payment were a contractual entitlement, the FCA would consider this to be a strong indication that the token is a security).

The substance of a virtual asset, and not the label ascribed to it, will determine whether a virtual asset is a Specified Investment. Thus a virtual asset which is described as a 'utility token' will still be a Specified Investment if it confers rights typical of a Specified Investment. The FCA guidance describes 'utility tokens' as tokens that provide consumers with access to a current or prospective product or service and often grant rights similar to pre-payment vouchers. The FCA generally considers utility tokens to be unregulated, except where they meet the definition of e-money tokens or security tokens. The FCA notes in its guidance that utility tokens can usually be traded on the secondary markets and be used for speculative purposes, but that does not in itself mean that they are specified investments if

¹⁰¹ <https://www.fca.org.uk/firms/financial-crime/cryptoassets-aml-ctf-regime>

they do not otherwise have the characteristics of specified investments. Virtual assets are most likely to fall within the following categories of Specified Investments: shares, debt instruments, warrants, certificates representing securities, units in collective investment schemes and rights and interests in investments. So let's take a look at the most relevant categories of specified investments for tokens.

Shares

Virtual assets conferring rights similar to shareholders' rights, such as voting rights, access to a dividend or rights to capital distribution on liquidation, are likely to be security tokens. Virtual assets representing ownership (through dividends and capital distribution) or control (through voting) are also likely to be security tokens. However, voting rights on direction which do not amount to control will not make a virtual asset a security tokens. The FCA gives the example of a virtual asset which gives the holder the right to vote on future ICOs the firm will invest in, and no other rights, as being unlikely to be considered a share, since the voting rights do not confer control-like decisions on the future of the firm.

Transferable securities

2019 FCA guidance on cryptoassets sets out the position as to when tokens may be considered "transferable securities" under the EU's MiFID (the Markets in Financial Instruments Directive). The UK has onshored provisions of the MiFID, including the regulation of "investment services and activities" in relation to "financial instruments". The categories of financial instruments under MiFID, including transferable securities, have been onshored to the UK's Regulated Activities Order. For a token to be considered a transferable security, it must be negotiable on the capital markets (that is it must be capable of being traded on the capital market). As such, tokens that confer rights like ownership and control and are capable of being tradeable on the capital markets are likely to be considered transferable securities. Importantly, a token which acts like a share but is not a transferable security, may still be capable of being a specified investment. An example may be where a token has the characteristics of a share but has a restriction on its transferability.

Debt instruments

A virtual asset which creates or acknowledges a debt owed by the issuer to the virtual asset holder is likely to be considered a debenture and will thus constitute a security token. If it is negotiable on the capital markets, it may also be a transferable security (other than in the case of government and public securities).

Warrants

As set out in PERG 2.6.13 of the Perimeter Guidance Manual in the FCA's Handbook, warrants are one of several categories of specified investment that are expressed in terms of the rights they confer in relation to other categories of specified investments. In particular, the rights conferred must be rights to 'subscribe' for the relevant investments – i.e. they must be rights to acquire the investments directly from the issuer and by way of issue of new investments (not by purchase of investments that have already been issued). If virtual assets are issued that give

holders the right to subscribe for specified investments (e.g. shares or debentures), the virtual assets will likely constitute warrants and will therefore be security tokens.

Certificates representing certain securities

A certificate or other instrument that confers contractual or property rights over other investments (e.g. shares or debentures) will be a specified investment if the other investment is owned by someone who is not the person on whom the certificate confers rights; and that other person's consent is not required for the transfer of the investments. Depositary receipts are specified investments within this category.

A virtual asset which confers rights in relation to tokenised shares or debentures, including depositary receipts, is likely to be a security token.

Units in a collective investment scheme

A collective investment scheme is an arrangement, the purpose or effect of which is to enable persons taking part in the arrangement to participate in, or receive profits or income arising from the investment, or sums paid out of such profits or income. The participants do not have day-to-day control over the management of the investment and the participants' contributions, and the profits from which payments are made, are pooled and/or the investment is managed as a whole by or on behalf of the scheme's operator (subject to certain arrangements which are excluded).¹⁰²

This category includes units in a unit trust scheme or authorised contractual scheme, shares in open-ended investment companies and rights in respect of most limited partnerships and all limited partnership schemes.

A virtual asset that acts as a vehicle through which profits or income are shared or pooled, or where the investment is managed as a whole by a market participant (e.g. the issuer of the virtual assets) is likely to be a collective investment scheme.

Rights and interests in investments

Rights to or interests in certain investments, including shares to units in a collective investment scheme, also constitute specified investments under the RAO.

Virtual assets that represent rights to or interests in other specified investments are therefore also likely to be securities. Hence a virtual asset that represents a right in a share will be a security token even though the virtual asset itself does not have the characteristics of a share.

Products referencing virtual assets

Products that reference virtual assets, like derivative instruments, are also likely to be specified investments as options, futures or contracts for difference under the

¹⁰²Financial Services and Markets Act 2000. Section 235.

RAO. According to FCA guidance on cryptocurrency, they may also be financial instruments under MiFID II. The MiFID categories of “financial instruments” have been onshored to the RAO.

Many of the categories of specified investments broadly overlap with the different categories of securities under the SFO (shares, debentures, structured products, regulated investment products and Collective Investment Schemes). So, in many senses, the UK’s approach to regulated tokens (in this case security tokens) is quite similar to Hong Kong’s regulatory approach. In Hong Kong, the SFC has however gone further so as to classify security tokens as “complex products”, which are investment products whose terms, features and risks are not reasonably likely to be understood by retail investors because of its complex structure, meaning that if an intermediary intends to distribute a complex product, additional investor protection measures must be adopted.

Comparably, in October 2020, the FCA voiced a similar sentiment with a ban on the sale of crypto derivatives to retail consumers. This decision followed a consultation in July 2019 on rules to address harm to retail consumers from the sale of derivatives and exchange traded notes referencing certain types of cryptoassets. The FCA stated that they considered these products to be “ill-suited” to retail consumers due to the underlying assets having no reliable basis for valuation, the prevalence of market abuse and financial crime in the secondary market for cryptoassets, the extreme volatility and inadequate understanding by retail consumers.¹⁰³ PS20/10 (an FCA Policy Statement) was then issued in October and the ban came into effect on 6 January 2021, with the FCA estimating that it would save retail investors around £53 million a year in losses and fees.¹⁰⁴

Notably, 97% of respondents to the consultation opposed the ban, arguing that the underlying assets do have intrinsic value and retail investors have the ability to assess them. Others, particularly retail investment advocates, did not agree and welcomed the ban citing that crypto trading advertisements targeting unsophisticated investors had “gone too far”.¹⁰⁵

As for Hong Kong, there has been no ban on crypto derivatives but the SFC has recognised and cautioned against the risks relating to crypto derivatives (in its December 2017 circular). Licensed exchanges are however prohibited from offering or trading crypto futures and crypto derivatives despite already being restricted to providing trading services only to professional investors. Similar restrictions are likely to apply to exchanges licensed under the proposed new regime for exchanges trading cryptocurrencies that are not securities.

Exchange Tokens

The FCA’s July 2019 guidance on the UK regulation of cryptocurrencies is set out in its Policy Statement 19/22. That guidance looks at regulation in relation to three

¹⁰³ <https://www.fca.org.uk/news/press-releases/fca-proposes-ban-sale-crypto-derivatives-retail-consumers>

¹⁰⁴ <https://www.ft.com/content/83bb20e3-141a-4f3a-a9ff-cd7bb4649a4d>

¹⁰⁵ <https://www.ft.com/content/83bb20e3-141a-4f3a-a9ff-cd7bb4649a4d>

types of cryptocurrencies (e-money tokens, security tokens and unregulated tokens).

The FCA generally considers “exchange tokens” to be ‘unregulated tokens’. Examples of “exchange tokens” are Bitcoin, Litecoin and equivalents. In Hong Kong, the term “exchange tokens” is not used. Bitcoin and other similar cryptocurrencies are commonly referred to as “payment tokens” (by the IRD).¹⁰⁶

Exchange tokens are used in a similar way to traditional fiat currency and can be used as a means of exchange, but are not currently viewed as legal tender in the UK and they are not considered to be a ‘currency’ or ‘money’. Hong Kong also does not consider the likes of Bitcoin and other similar cryptocurrencies to be legal tender, instead they are classified as “virtual commodities”.

Exchange tokens are said to be more volatile than currencies and commodities (bearing in mind the UK does not consider cryptocurrencies to be commodities). The Guidance explains that because of this volatility, exchange tokens are not widely used as a means of exchange in the UK outside of the crypto and digital communities and are typically used as a unit of account or a store of value.

Generally, exchange tokens do not grant the holder any rights associated with Specified Investments. This is because exchange tokens tend to be decentralised with no central issuer obliged to honour those contractual rights, if any such contractual rights were to exist.

The fact that an exchange token can be acquired and held for speculative purposes rather than exchange, with holders expecting the tokens to increase in value, is not sufficient to bring the exchange token within the definition of a Specified Investment. The FCA gives the analogy of a person holding a different fiat currency or a commodity in anticipation of an increase in value. It notes that this approach aligns with its approach to other products which are not FCA-regulated, such as art or fine wine which may also be considered to have speculative value.

Exchange tokens fall under the category of unregulated tokens, therefore the FCA does not currently regulate activities in exchange tokens. So, the operation of a virtual asset exchange which only trades exchange tokens and the transfer or trading of exchange tokens on exchanges are currently outside the scope of FCA regulation. This is also the case in Hong Kong, where exchanges are required to be licensed and regulated where they trade at least one security token (which Bitcoin is not). However, there is an FSTB proposal which would bring all virtual asset exchanges within the SFC’s regulatory reach.

AML/CFT Regulation of Crypto Activity in the UK

While the operation of a virtual asset exchange falls outside the FCA’s regulatory ambit, amendments to the UK’s Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the “**MLRs**”) extended AML and CTF regulation to “cryptoasset exchange providers” (**CEPs**) and

¹⁰⁶ <https://home.kpmg/cn/en/home/insights/2020/04/tax-alert-8-hk-taxation-of-digital-assets-in-hk.html>

“custodian wallet providers” (**CWPs**) from 10 January 2020. The revised MLRs apply to cryptoasset exchange providers and custodian wallet providers which carry on business in the UK. Both types of entity are now included in the definition of ‘relevant persons’ and are now under the same AML and CTF obligations to carry out customer due-diligence and report suspicious transactions as the other entities categorised as obliged entities, such as financial institutions and money service businesses.

Cryptoasset exchange providers and custodian wallet providers are required to register for AML supervision with the FCA, as the responsible authority for supervision and enforcement of the AML/CTF aspects of cryptoasset businesses. In Hong Kong, similar developments are underway with the FSTB proposal, which will extend the application of the provisions of Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (**AMLO**) to a wider scope of crypto businesses, with the SFC being the responsible authority for licensing and supervision. The Hong Kong consultation closed on 31 January 2021, however it may be some time before the regime is put in place.

Key definitions under the UK's Money Laundering Regulations

“*Cryptoasset exchange provider*” - means a firm or sole practitioner who by way of business provides one or more of the following services, including where the firm or sole practitioner does so as creator or issuer of any of the cryptoassets involved, when providing such services –

- i. exchanging, or arranging or making arrangements with a view to the exchange of, cryptoassets for money or money for cryptoassets;
- ii. exchanging, or arranging or making arrangements with a view to the exchange of, one cryptoasset for another; or
- iii. operating a machine which utilises automated processes to exchange cryptoassets for money or money for cryptoassets.

Cryptoasset exchange providers thus include crypto exchanges which exchange cryptoassets for money or other cryptoassets, the operators of crypto ATMs and the issuers of cryptoassets in initial coin offerings or initial exchange offerings. The definition would also capture the operators of peer-to-peer exchanges which facilitate the exchange of cryptoassets for money or other cryptoassets between buyers and sellers

“*Custodian wallet providers*” - an entity that provides services to safeguard or safeguard and administer cryptoassets on behalf of its customers or private cryptographic keys on behalf of its customers in order to hold, store and transfer crypto assets.

Under the MLRs, a cryptoasset is defined as a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can be transferred, stored or traded electronically. The definition includes a right to, or interest in, the cryptoasset. The definition of cryptoasset brings into scope (i) exchange tokens; (ii) security tokens; and (iii) utility tokens.

This definition goes further than the definition of virtual assets used in the FATF Recommendations. The result is that in the UK, the scope of cryptoassets that are subject to the new AML/CFT regime is broader than if the FATF definition of virtual assets had been adopted.

In short, these new regulatory measures mean that all businesses carrying on cryptoasset activity in the UK are required to register with the FCA and comply with the MLRs. Thus, previously unregulated cryptoasset businesses are now subject to the same AML/CFT obligations as financial institutions in the UK.

The AML/CTF regime for businesses engaging in activities related to virtual assets is broader than is currently proposed for Hong Kong. Even with the implementation of the proposed new licensing regime under Hong Kong's Anti-Money Laundering and Counter-Terrorist Financing Ordinance, Hong Kong will only impose AML and CTF obligations on crypto exchanges. Unlike the UK, Hong Kong is not planning at this stage to bring crypto ATMs or providers of crypto custody services as a standalone business within the ambit of its regulation.

Utility Tokens

Utility tokens also fall within the category of unregulated tokens. The FCA describes utility tokens as virtual assets that provide consumers with access to a current or prospective service and often grant rights similar to pre-payment vouchers. In some instances, utility tokens may have similarities with or be the same as, rewards-based crowdfunding. In these cases, the participants will contribute funds to a project, in exchange usually for a reward, for example access to products or services at a discount. Reward-based crowdfunding models are not regulated by Hong Kong's securities legislation and a number of reward-based models have been set up in Hong Kong, including FringeBacker, SparkRaise and Dreamna.

Like exchange tokens, utility tokens can normally be traded on the secondary markets and be used for speculative investment purposes. However, the FCA notes in its guidance that this does not of itself mean that they are Specified Investments if they do not have features that would render them Specified Investments. The FCA guidance does however note that exchange tokens may in certain circumstances meet the definition of e-money, in which case their issue will be regulated under the Electronic Money Regulations.

Hong Kong's regulatory approach to utility tokens is broadly similar, and the SFC has suggested that utility tokens are not securities within the definition in the SFO (in its statement of February 2018). Given the absence of case law, particularly on the definition of interests in a collective investment scheme, it is however difficult to predict how a Hong Kong court would view an offer of utility tokens.

Use of Virtual Assets to Facilitate Regulated Payment Systems

The provision of payment services in the UK are regulated under the Payment Services Regulations (the **PSRs**), which cover certain activities when carried out as a regular occupation or business activity (including for example, execution of payment transactions, card issuing, merchant acquiring and money remittance).

Activities which do not constitute payment services include cash payments made directly between payers and payees.

The Payment Services Regulations apply to “funds” which are defined as “banknotes and coins, scriptural money and electronic money”. They therefore do not generally apply to virtual assets. However virtual assets can constitute e-money in certain circumstances and the provision of payment services in virtual assets which qualify as e-money would then be regulated under the PSRs. The use of cryptocurrency as an intermediary currency in money remittance may also involve providing a payment service regulated under the Payment Service Regulations. For example, where fiat currency is converted first into virtual assets and then back into another fiat currency before transmission to the recipient, the service will be regarded as a regulated payment service, although the cryptocurrency is not itself regarded as a regulated financial product.¹⁰⁷

Exchange tokens can also be used to facilitate regulated payment services such as international money remittance (to enable remittances to occur quicker and cheaper), however this would fall outside the scope of the PSRs.

E-money

E-money issuance is regulated under the [Electronic Money Regulations 2011 \(EMRs\)](#) and is a regulated activity under article 9B of the Regulated Activities Order when carried on by credit institutions, credit unions and municipal banks. As such, firms that issue e-money must ensure that they are appropriately authorised or registered. Similarly, in Hong Kong, institutions engaging in e-money related payment services must be licensed by the HKMA.

The UK defines e-money as electronically stored monetary value as represented by a claim on the electronic money issuer which is:

- i. issued on receipt of funds for the purpose of making payment transactions;
- ii. accepted by a person other than the electronic money issuer; and
- iii. not excluded by regulation 3 of the Electronic Money Regulations.

In order to be considered as e-money, a virtual asset must enable the user to make payment transactions with third parties, meaning the e-money must be accepted by more parties than only the issuer.

Fiat balances in online wallets or prepaid cards constitute e-money. However, exchange tokens such as Bitcoin, Ether and similar virtual assets are unlikely to constitute e-money because, among other things, they are not normally centrally issued on the receipt of funds, nor do they represent a claim against the issuer.

Distributed ledger technology (**DLT**) and cryptographically secured tokens can be used to represent fiat funds. The FCA guidance notes that virtual assets that

¹⁰⁷ <https://thelawreviews.co.uk/edition/the-virtual-currency-regulation-review-edition-3/1230210/united-kingdom>

establish a new type of unit of account (rather than representing fiat funds) are unlikely to constitute e-money unless the value of the unit is pegged to a fiat currency, but even then, it will still depend on the facts of the case. Firms have used DLT-based e-money to provide more efficient and automated services (including for international payments) within the FCA's sandbox.

Hong Kong's Monetary Authority (the **HKMA**) has said that it does not regard Bitcoin as e-money.¹⁰⁸

Stablecoins

Stablecoins are virtual assets where attempts have been made to stabilise their value using various mechanisms. Many stablecoins are pegged to a fiat currency (typically the US dollar and usually with a 1:1 backing), with the aim of reducing volatility. Stablecoins can also be stabilised in other ways, for example by being backed by particular assets which could include Specified Investments or commodities such as gold or a basket of cryptoassets. Other stablecoins are stabilised using algorithms that increase or decrease the supply of the stablecoin to maintain a stable price.

In the UK, stablecoins can fall into any of the three categories of tokens (e-money tokens, security tokens or unregulated tokens), although the HM Treasury most recently stated in its January 2021 consultation paper that they are currently more likely to be unregulated exchange tokens or e-money tokens.¹⁰⁹ However, in this consultation paper, the UK outlines its proposal to introduce a new category of regulated tokens to capture stablecoins – to be known as “stable tokens”, with the proposed regulatory regime covering stable tokens used as a means of payment. This would cover entities issuing stable tokens, and firms providing services relating to them, to consumers (either directly or indirectly). The UK Government outlined that they are seeking to regulate stablecoins due to their potential application to retail and wholesale transactions and the risks they present for consumers.¹¹⁰

It is proposed that the scope of the definition will extend to stablecoins that are linked to a single fiat currency and stablecoins whose value is linked to an asset other than a single fiat currency (for example, gold or multi-currency). Algorithmic stablecoins will be excluded from the scope of the proposals for the time being, as will security tokens, which are already regulated.¹¹¹ As for e-money tokens, they are regulated under the e-money regulations and it is proposed that those requirements will continue to apply. However, where e-money tokens are also stable tokens, they may be subject to enhanced requirements under the new regime if they have “significant potential” to become systemic.¹¹²

¹⁰⁸ HKMA. “The HKMA reminds the public to be aware of the risks associated with Bitcoin”. (Feb 2015). <https://www.hkma.gov.hk/eng/news-and-media/press-releases/2015/02/20150211-3/>

¹⁰⁹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/950206/HM_Treasury_Cryptoasset_and_Stablecoin_consultation.pdf

¹¹⁰ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/950206/HM_Treasury_Cryptoasset_and_Stablecoin_consultation.pdf

¹¹¹ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/950206/HM_Treasury_Cryptoasset_and_Stablecoin_consultation.pdf

¹¹² https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/950206/HM_Treasury_Cryptoasset_and_Stablecoin_consultation.pdf

In Hong Kong, as is the position in the UK currently, there is no distinct regulatory regime or framework for stablecoins. Their classification and regulation of related activities ultimately depends on a number of considerations (i.e., do they have a central issuer, the underlying asset or assets and so on).

AUSTRALIA

ICOs

The Australian Securities & Investments Commission (**ASIC**) updated its information on ICOs and virtual assets set out in its Information Sheet 225 Initial Coin Offerings and crypto-assets (**INFO 225**) on 30 May 2019. INFO 225 sets out how the Corporations Act may apply to the raising of funds through an ICO and to other activities involving virtual assets such as cryptocurrencies, tokens or stablecoins.

Under the current regulatory regime, when the virtual asset issued in an ICO is a financial product, the issuer will need to consider and comply with the relevant capital raising provisions of the Corporations Act, Australian financial Services licensing requirements and other regulatory requirements. For non-financial products, no regulatory restraint on capital raising exists but entities are still expected to comply with relevant laws and obligations such as the Corporations Act, ASIC Act, Australian Consumer Law, anti-money laundering (**AML**) and know your client (**KYC**) obligations.

ICOs constituting or involving a financial product

The Corporations Act is likely to apply to an ICO that involves a financial product such as a managed investment scheme, security, derivative or non-cash payment (**NCP**) facility. Australia, like Hong Kong, does not consider Bitcoin to be a financial product.

The key consideration when assessing an ICO's legal status as a financial product are the rights attached to the virtual assets which are normally set out in the ICO's 'white paper', the offer document issued by the business making the offer or sale of an ICO virtual asset. However, rights (a term which is broadly interpreted to include possible future rights, contingent rights and rights that may not be legally enforceable) can also be determined from other circumstances (e.g., how the ICO or cryptoasset is marketed to potential investors). However, the characterisation of an ICO or crypto asset can evolve over time (i.e., over the course of product development), so it is important that this is monitored, and that ongoing disclosure is made to investors where necessary.¹¹³

Importantly, whether an ICO constitutes or involves a financial product or not, the Australian Consumer Law applies and so the prohibitions against misleading or deceptive conduct must be adhered to.¹¹⁴

¹¹³ <https://blockchain.bakermckenzie.com/2019/06/17/australian-regulator-provides-update-to-ico-and-crypto-asset-information/#page=1>

¹¹⁴ <https://blockchain.bakermckenzie.com/2019/06/17/australian-regulator-provides-update-to-ico-and-crypto-asset-information/#page=1>

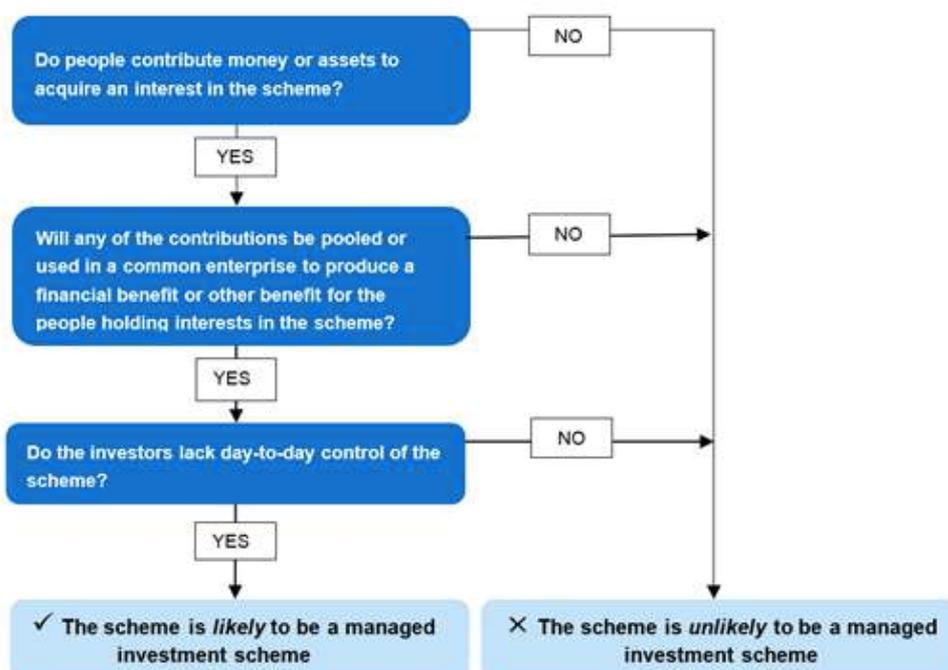
Managed investment schemes (**MIS**)

Types of financial products - Managed Investment Schemes (**MIS**).

The ASIC has outlined that, in their experience, many ICOs involve interests in a managed investment scheme, which is a form of collective investment vehicle comprised of three elements:

- i. the contribution of money or assets (e.g., other virtual assets) to acquire an interest in the scheme (which will typically be a type of 'financial product' under the Corporations Act);
- ii. any of the contributions are pooled or used in a common enterprise to produce financial benefits or interests in property (e.g., using funds raised from contributors to develop the platform), for purposes that include providing a financial benefit for contributors (e.g., from an increase in the value of their cryptoassets); and
- iii. contributors lack day-to-day control over the operation of the scheme but, at times, may have voting rights or similar rights.

If the rights and value of the virtual assets are related to an arrangement where these three elements are present, the virtual asset issuer is likely to be offering interests in a managed investment scheme. In particular, ASIC has stated that where an ICO issuer frames the entitlements received by contributors as a receipt for a purchased service and the value of the virtual assets acquired is affected by the pooling of funds from contributors, or the use of those funds under the arrangement, then the ICO is likely to be a managed investment scheme. This is particularly likely to be the case where the ICO is offered as an investment.



Source: <https://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings-and-crypto-assets/#part-c>

However, it is not clear in what circumstances an ICO will be deemed to produce a financial or other benefit for those holding interests in the scheme. It would seem to clearly cover the situation where the ICO operates essentially as a tokenised fund – e.g., where the amounts paid by subscribers of the cryptoassets are used to invest in properties or companies and the profits arising from those investments are shared among the holders of the cryptoassets.

It is however less clear whether it would cover the situation in which cryptoasset purchase monies will be used to develop the issuer’s platform which will provide certain services to the holder of the cryptoasset in the future, which will be paid for using the cryptoasset. The questions in that scenario are:

- Would the future services available to holders of the virtual assets constitute a “benefit” which would bring the arrangement within the scope of a “managed investment scheme”?
- If the value of the virtual assets increases such that holders can realise a gain on selling their virtual assets (either on a virtual assets exchange or privately), would this be a “benefit” which would bring the arrangement within the scope of a “managed investment scheme”? The difficulty here is establishing that it is the pooling of the contributions (and the actions of the issuer in developing its platform) which gives rise to the “benefit” (i.e. the rise in value of the virtual assets) for the holders.

Implications where an ICO is a managed investment scheme

In this case, the issuer of the tokens must comply with the registration, licensing and reporting requirements such as, in the case of a retail scheme, registering the scheme with ASIC and obtaining an AFS licence to act as a responsible entity and in the case of a wholesale scheme, obtaining an AFS licence with the appropriate authorisations.¹¹⁵

An ICO as an offer of a security

Where an ICO is not a managed investment scheme, it may be considered an offer of a security. This may be the case where an ICO is created to fund a company (or fund an undertaking that looks like a company), in which case, the rights attached to the crypto asset issued in the ICO may fall within the definition of a security, possibly as a share or an option to acquire a share in the future.¹¹⁶ The prospectus requirements would then apply, as they do to IPOs.

Non-cash Payment Facilities (NCPs)

¹¹⁵ <https://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings-and-crypto-assets/#part-c>

¹¹⁶ <https://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings-and-crypto-assets/#part-c>

Non-cash payment facilities (**NCPs**) are arrangements through which a person makes payments, or causes payments to be made, other than by the physical delivery of currency. These facilities can be a financial product which requires an AFS licence if payments can be made to more than one person.

The ASIC has stated that tokens offered in an ICO are unlikely to be NCPs, although they may be a form of value that is used to make a payment (instead of physical currency). An ICO may involve an NCP facility if it includes an arrangement that allows: payments to be made in a form of value (instead of physical currency) to a number of payees; or payments to be started in a form of value (not a physical currency) and later converted to fiat currency to enable completion of the payment. Generally, an AFS licence may be needed if an ICO involves an NCP facility. In some cases, however, exemptions (e.g., a low-value exemption) may apply.

Financial Market Operation

A financial market is a facility through which offers to acquire or dispose of financial products are regularly made. Where a virtual asset is a financial product (as a security, a managed investment scheme, a derivative or NCP facility), then any platform that enables consumers to buy, be issued with, or sell such a virtual asset may involve the operation of a financial market. In this case, the operator must hold an Australian market licence, unless covered by an exemption. Currently, there are no licensed or exempt platform operators in Australia that enable consumers to buy, be issued with or sell virtual assets that are financial products. Where the crypto assets are not financial products, trading platforms are not subject to the regulatory oversight of the ASIC.

Financial Products that Reference Virtual Assets

Entities may also propose to issue financial products that are linked to, or reference, virtual assets; invest in virtual assets; or otherwise enable consumers to have exposure to virtual assets. In these cases, the entities will be providing a financial service in issuing such financial products and may require a new Australian Financial Services (**AFS**) licence or licence variation (such as a new product authorisation).

Anti-Money Laundering and Counter-Terrorist Financing

Australia has amended its Anti-Money Laundering and Counter-Terrorism Financing Act of 2006 to regulate the operators of digital currency exchanges. The revised legislation came into effect in April 2018 and requires digital currency exchanges to register with AUSTRAC. Registered exchanges are required to comply with anti-money laundering and counter-terrorist financing obligations.

A digital currency exchange service is one which involves converting crypto assets for fiat currency or fiat currency for crypto assets. Where the service is provided as a business, the exchange needs to be registered as a digital currency exchange with AUSTRAC unless an exemption applies. Exchanges which only exchange crypto assets for other crypto assets are currently outside the scope of the legislation, although that may change in the future.

How Australia's Regulation Compares to Hong Kong

Generally, Australia and Hong Kong's regulators take similar approaches to the regulation of virtual assets, in that neither specifically regulate virtual assets except where they constitute "securities" (in Hong Kong) or more generally "financial products" in Australia. The application of Australia's AML and CTF regime to crypto exchanges is however narrower than is proposed for Hong Kong since crypto-to-crypto exchanges are not currently within the scope of Australian AML/CTF regulation. In Hong Kong, exchanges which trade any virtual asset which is a "security" are already required to be licensed by the SFC and must comply with the AML and CTF obligations for licensed entities. If the proposals for licensing exchanges that trade virtual assets that are not securities go ahead, they too will be subject to AML/CTF compliance, even if they only exchange virtual assets for other virtual assets.

MALTA

Malta is one of a number of jurisdictions which have sought to establish themselves as crypto hubs by adopting crypto-friendly regulation. Malta was one of the first jurisdictions to implement laws setting the regulatory framework for blockchain and DLT, cryptocurrency and digital assets. In November 2018, the Virtual Financial Assets Act (**VFA Act**) (governing ICOs and virtual asset exchanges and service providers) came into effect (together with two other laws), with the aim of positioning Malta as one of the world's leading blockchain jurisdictions.

Despite this progress, Malta has had its fair share of problems. Binance, being one of the largest crypto exchanges was said to have been operating out of Malta. However, in February 2020, the Malta Financial Services Authority (**MFSA**) issued a statement denying that Binance had ever been regulated in Malta or that the exchange ever had leave to operate in Malta, stating that "Binance is not authorised by the MFSA to operate in the cryptocurrency sphere and is therefore not subject to regulatory oversight by the MFSA."

The second largest crypto exchange, OKEx still appears to be operating from Malta and in September 2020, two crypto exchanges (Bluetrade and BeQuant) announced plans to set up operations in Malta.¹¹⁷

Malta's ambitions and much hyped 'blockchain island' dreams are however dwindling fast. Malta's Financial Services Authority (the **MFSA**) has reported that 57 or 70% of the companies which were allowed to provide VFA services during a transition phase ending in October 2019 failed to apply for a VFA service licence to continue providing those services. Only 26 companies, of which a majority were cryptocurrency exchanges, proceeded to initiate the application procedures under the VFA Act. A handful of companies received in-principle approval at the end of 2020. In November 2020, Crypto.com announced that it had received in-principle approval for a Class 3 VFA license (one of the first crypto platforms to receive this)

¹¹⁷ <https://corriericilia.com/another-two-cryptocurrency-exchanges-announce-move-to-malta>

allowing them to provide VFA services (but not operate a crypto exchange)¹¹⁸ and in December 2020, CoinDeal announced it was the first company to obtain in-principle approval for a Class 4 VFA licence allowing them to operate a VFA exchange and provide VFA services.¹¹⁹

Virtual Financial Assets Act

The VFA Act sets out the framework for virtual financial assets, including ICOs, and entities that deal with them such as virtual asset exchanges, investment advisers, custodian wallet providers, brokers and portfolio managers.

Malta adopted a Financial Instruments Test which must be conducted by anyone proposing to issue an ICO in or from Malta to determine the type of asset being created and the law applicable to the ICO and the token itself. Where the asset in question is determined to be a “virtual financial asset” or “VFA” (defined as any form of digital medium of recordation that is used as a digital medium of exchange, unit of account or store of value that is not a financial instrument, a virtual token or electronic money) it will be regulated under the VFA Act.

- i. financial instrument – a financial instrument is as defined under the EU’s Markets in Financial Services Directive (**MiFID**) and Malta’s Investment Services Act and activities related to financial instruments are regulated under the Investment Services Act;
- ii. virtual token – a token whose utility, value or application is restricted solely to the acquisition of goods or services, either solely within the DLT platform on or in relation to which it was issued or within a limited network of DLT platforms. Virtual tokens are typically utility tokens whose only utility and value is to acquire goods or services within the DLT platform on which they are issued. Activities relating to virtual tokens are unregulated; and lastly,
- iii. electronic money - to qualify as electronic money, a DLT asset must be issued at par value on receipt of funds by the issuer and be redeemable at any time only by the issuer. It should be used for making payments and must be accepted by a person other than the issuer as a means of payment.

If a DLT asset is convertible into another type of DLT asset, it will be treated as the DLT asset type into which it may be converted. Generally, most virtual assets will be virtual financial assets.

Compared to Hong Kong, the main difference is that Hong Kong currently has no specific legislation applying to ICOs or virtual assets. That will change however if the FSTB’s November 2020 proposals for the licensing of virtual asset exchanges under Hong Kong’s anti-money laundering legislation are implemented. Further, in Hong Kong, there is no strict distinction between the different types of tokens,

¹¹⁸ <https://blog.crypto.com/crypto-com-receives-in-principle-approvals-for-a-financial-institution-license-and-a-class-3-vfa-license/>

¹¹⁹ <https://www.crowdfundinsider.com/2020/12/170434-coindeal-claims-first-class-4-virtual-financial-assets-licence-license-in-malta/>

save for when tokens have the characteristics of a security. Otherwise, all tokens are considered virtual commodities.

Whitepaper Content Requirements

The VFA Act does not require issuers to be licensed or registered by the MFSA, however they are required to issue a whitepaper which meets various requirements specified in the VFA Act. This requirement applies to any entity which proposes to (i) offer a virtual financial asset to the public in or from Malta or (ii) apply to trade a virtual financial asset on a DLT exchange. The definition of a VFA issuer refers only to legal entities formed under the laws of Malta. Thus, issuers must be incorporated in Malta if they wish to conduct a VFA offering (i.e. an ICO). A whitepaper is not required if the DLT asset is determined to be a virtual token (which is not regulated by the VFA act). VAIOT announced the successful registration of its whitepaper with the MFSA in October 2020, becoming the first project to be regulated under the VFA Act.¹²⁰

Issuer Obligations

VFA issuers are required to comply with the issuer obligations which, very briefly, relate to conducting the business with honesty and integrity and with due skill, care and diligence; investor communication, conflicts of interest, protection of investors' funds, administration arrangements, security and compliance with AML/CFT regulation.

Issuers will be liable to compensate any person who suffers loss resulting directly result from the purchase of virtual financial assets either as part of an initial VFA offering or on a DLT exchange on the basis of untrue information contained in the white paper, on the issuer's website or in an advertisement relating to the virtual financial assets.

This compares to the SFC's regulatory approach where the investor protection measures of the SFC's Code of Conduct only apply where a traditional intermediary is involved and as the SFC's Code of Conduct does not apply to issuers of securities, there is therefore no obligation under the Code of Conduct on the issuer in a typical security token offering to ensure the accuracy of the information provided in its marketing documents nor to assess the suitability of its tokens for prospective purchasers. However, an issuer which makes false or misleading statements in its white paper may be liable for fraud, theft or misrepresentation.

VFA Agent Requirements

In Malta, the issuer of an ICO must appoint a VFA agent approved by the MFSA on an ongoing basis. Lawyers, accountants and corporate service providers can apply for approval as a VFA agent. The VFA agent is responsible for advising and guiding the issuer as to its responsibilities and obligations under the VFA Act and related rules and regulations. It must form an opinion that the issuer has complied with all applicable regulatory requirements in relation to the offer of virtual financial assets

¹²⁰ <https://www.internationalinvestment.net/news/4022251/vaiot-firm-register-maltese-fintech-framework>

or their admission to trading on an exchange (as the case may be) and must consider the issuer to be fit and proper. The VFA agent acts as a point of liaison between the issuer and the MFSA and must submit all documentation required under the VFA Act and related rules and regulations. In particular, it must submit a certificate of compliance to the MFSA annually confirming that the issuer is in compliance with the regulatory requirements. The VFA agent must disclose any material information relating to regulatory non-compliance to the MFSA.

Requirements for Advertisements

The VFA Act specifies requirements for advertisements issued in relation to an initial VFA offering or the admission of a VFA to trading on a VFA exchange. Any advertisement must be clearly identifiable as such and the information it contains must be accurate and not misleading and must be consistent with the information contained (or to be contained) in the white paper. The advertisement must contain a statement that a white paper has been or will be issued and give the addresses and times at which copies are or will be available to the public. Advertisements related to a VFA service can only be issued by a VFA licence holder or by another person where the licence holder's board of administration has vetted and approved its contents.

VFA Service Providers

The provision of VFA services in or from Malta requires the provider to be licensed by the MFSA. Examples of VFA services include portfolio management, custodian or nominee services, providing investment advice in relation to virtual financial assets, placing virtual financial assets, operating a VFA exchange, reception and transmission of orders relating to virtual financial assets, execution of orders and dealing on own account.

Application for the Licence

An entity seeking a VFA licence must appoint a registered VFA agent to submit the application. The MFSA may grant or refuse to grant a licence, which may be general or restricted to the provision of specified VFA services. The grant of a licence requires the MFSA to be satisfied on an ongoing basis that:

- i. the applicant (and its beneficial owner, qualifying holder, members of the board of administration or any other person who directs the business of applicant) is fit and proper to provide the relevant VFA services and complies and observes the requirements of the VFA Act and other relevant regulations and rules;
- ii. if the applicant is a natural person, that such person is a resident of Malta;
- iii. if the applicant is a legal person, that it is either constituted in Malta or in accordance with Malta's laws or in a recognized jurisdiction and has established a branch in Malta. Its purposes or objects must be limited to acting as a licence holder and carrying out ancillary or incidental activities, and must not include purposes or objects which are not compatible with the VFA services of a licence holder. Non-compatible purposes or objects

include any activity that requires authorisation by the MFSA under any Maltese law other than the VFA Act; and

- iv. its actual activities are compatible and related to VFA services.

The licence may be granted subject to any conditions the MFSA deems appropriate, and may be subsequently revoked or additional conditions may be imposed. The MFSA's decisions to grant or refuse to grant a licence will be guided by its objectives of investor and public protection, protection of Malta's reputation, promotion of innovation and competition and the sustainability and reputation of the applicant and parties connected to it.

There are a number of other grounds on which the MFSA may refuse to grant a licence, including if it considers that the applicant does not have sound and prudent management, robust administration arrangements and adequate internal control or security mechanisms, or that the applicant has close links to a person or persons that prevent it from exercising effective supervision of the applicant, or that granting a licence to the applicant could pose a risk to investors, the general public, Malta's reputation, and promotion of innovation or competition.

The MFSA can suspend or cancel a licence for reasons which include but are not limited to the following:

- i. a licence holder does not start to provide the VFA service within 12 months from the date of issue of the licence;
- ii. a licence holder has ceased operations as a result of a merger;
- iii. if the licence holder is declared bankrupt, goes into liquidation or makes a composition with its creditors or is otherwise dissolved; or
- iv. at the written request of another competent regulatory authority regulating the licence holder.

Licence holders' conduct and obligations

The VFA Act imposes standards of conduct on licence holders including requirements that they act honestly, fairly and professionally; comply with the requirements of the VFA Act and any related rules and regulations; and owe fiduciary duties towards their customers. Licence holders must maintain systems and security access protocols to appropriately high standards.

Comparison to Hong Kong's Regulatory Regime

Hong Kong is proposing to introduce a new licensing regime for operators of virtual asset exchanges, which if adopted, would be much narrower in scope than Malta's licensing regime. A number of other activities in Hong Kong are already regulated including operating a trading platform where at least one virtual asset traded is a "security", managing a fund investing in virtual assets in certain circumstances, and distributing a fund that invests in virtual assets.

Prevention of Market Abuse

The VFA Act creates offences of insider dealing, market manipulation and unlawful disclosure of inside information in relation to virtual financial assets that are admitted to trading on a VFA exchange, whether carried out in or outside Malta:

1. Insider dealing – intentionally recommending or inducing another person to engage in insider dealing is an offence. Insider dealing occurs where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, virtual financial assets to which that information relates. It also occurs where a person possesses inside information and recommends, on the basis of that information, that another person acquire or dispose of virtual financial assets to which that information relates, or induces that person to make an acquisition or disposal, or that another person cancel or amend an order concerning a virtual financial asset to which that information relates, or induces that person to make such a cancellation or amendment. Use of the recommendations or inducements constitutes insider dealing where the person using the recommendation or inducement is aware that it is based upon inside information.
2. Unlawful disclosure of inside information where a person possesses inside information and discloses that information to any other person, except where the disclosure is permitted by the VFA Act and regulations or rules issued under it. Inciting, aiding or abetting such an offence is also an offence.
3. Market manipulation is defined as the manipulation or attempted manipulation of a virtual financial asset or a benchmark through the use of an abusive strategy.

VFA exchanges are required to have effective systems, procedures and arrangements in place to monitor and detect market abuse and must report any suspicion of market abuse to the MFSA.

Licence holders' auditor

A licence holder will be required to appoint an auditor who has a duty to report to the MFSA any fact or decision that is likely to lead to a serious qualification to, or refusal of, the auditor's report on the accounts of the licence holder, or is likely to constitute a material breach of applicable legal or regulatory requirements, or impairs the licence holder's ability to continue its activities. Any person having close links with such a licence holder must also be reported to the MFSA by the auditor. The auditor must simultaneously communicate the information to the board of administration of the licence holder, unless the auditor knows of compelling reasons not to do so. The auditor is required to report to the MFSA annually on the systems and security protocols of the licence holder.

It is an offence for a person to induce or attempt to induce another person to enter into a VFA agreement by knowingly making statements that are misleading, false or deceptive. Any person intentionally obstructing another person from exercising rights given by the VFA Act will also be guilty of an offence. Offences under the VFA Act are punishable by a fine of up to EUR 15 million, a fine up to three times the

greater of the profits made or losses avoided by the offence, or by imprisonment for a maximum six years, or both fine and imprisonment. The VFA Act also imposes reporting obligations with respect to suspected money laundering and terrorist financing. If an officer or an employee of a VFA issuer, VFA agent or licence holder considers that a transaction may involve money laundering or terrorist financing, they must report this in compliance with Malta's Prevention of Money Laundering Act.

GIBRALTAR

Gibraltar is an example of a jurisdiction which has introduced regulations aimed at attracting blockchain and crypto companies. Gibraltar's approach has been dubbed "progressive" and "right touch"¹²¹ and as a result, the territory has emerged as a jurisdiction of choice for many crypto firms.

DLT Regulatory Framework

Gibraltar has developed a bespoke regime, known as the DLT regulatory framework, which took effect on 1 January 2018 and applies to firms that carry on DLT activities – that is activities that are not subject to regulation under any other regulatory framework that use distributed ledger technology (**DLT**) for the transmission or storage of value belonging to others. The types of activities that require a DLT licence include operating a crypto exchange, custodian service providers and asset storage service providers, crypto wallet providers and operating DLT-based marketplaces that facilitate the buying and selling of goods and services. Firms and activities that are subject to another regulatory framework continue to be regulated under that framework. Firms carrying on a business in DLT Activities, including crypto trading exchanges and custodians, need to be authorised and licensed as DLT Providers by Gibraltar's Financial Services Commission (**the GFSC**). There are currently 12 licensed DLT Providers including eToro, Huobi and Xapo.

Gibraltar's regulatory approach to DLT is outcome-focused, not prescriptive, requiring DLT Providers to comply with nine principles designed to ensure achievement of desired regulatory outcomes, including investor protection.

In their licensing applications, applicants must demonstrate how they will comply with the nine principles:

- i. conducting the business with honesty and integrity – the GFSC must be satisfied that the applicant and people associated with the applicant, are fit and proper to undertake the relevant DLT activity. The basic elements that the GFSC has set out are (i) honesty, integrity and reputation; (ii) skill, competence, care and experience; and (iii) financial position;
- ii. pay due regard to customers' interests and needs and to communicate with its customers in a way which is fair, clear and not misleading. The DLT provider must among other things use its best endeavours to mitigate the

¹²¹ <https://www.mondaq.com/gibraltar/fin-tech/1009674/isolas-llp-advises-on-launch-of-private-cryptocurrency-fund>

risks associated with use of DLT and employ best practices in operating its business;

- iii. maintaining adequate financial and non-financial resources – the DLT provider must ensure that it has sufficient financial resources and capital levels which must both be monitored and be sufficient to support the business objectives;
- iv. manage and control the business effectively and conduct its business with due skill, care and diligence; including having proper regard to risks to its business and customers – which includes adopting appropriate forward-looking risk management practices;
- v. have effective arrangements in place for the protection of client assets and money when it is responsible for them – DLT providers are expected to take the necessary precautions to protect customer assets and custodial assets will need to be segregated from the DLT Provider's own assets;
- vi. effective corporate governance arrangements put in place – DLT providers must adopt strong corporate governance procedures which should include (a) board structure, including composition to ensure that there is a good balance and mix of skills and experience to complement the business; (b) adequate application of the 'four eyes' principle (segregation of various functions, cross-checking, double signatures, dual control of assets etc.) and (c) application of mind and management from Gibraltar;
- vii. ensure that all systems and security access protocols are maintained to appropriate high standards;
- viii. prevention of financial crime - DLT providers are required to have systems in place to prevent, detect and disclose financial crime risks such as anti-money laundering and countering terrorist financing (AML/CFT). DLT providers must adopt and apply adequate anti-money laundering and counter terrorist financing preventative measures which are commensurate with their risks and the DLT providers must also report suspicious transactions when applicable; and
- ix. be resilient and develop contingency plans for the orderly and solvent wind down of its business.

On 12 January 2021, it was announced that Gibraltar is looking to add a 10th principle to the DLT framework, following the convening of a working group in late 2020. The latest principle will be aimed at defining the appropriate market standards for exchanges operating in the digital asset space and is on track for “a prompt delivery”.¹²²

These principles are similar in some ways to the Terms and Conditions which are imposed on virtual asset trading platform operators in Hong Kong under the SFC's

¹²² <https://www.gibraltar.gov.gi/press-releases/working-group-convenes-to-deliver-10th-principle-of-gibraltars-dlt-regulatory-framework-442021-6591>

current “opt-in” regime, which covers the safe custody of assets, KYC, AML/CFT, preventing market manipulative and abusive activities, accounting and auditing, risk management and conflicts of interest. These Terms and Conditions are also likely to be applied under the proposed regime for licensing exchanges that only trade non-security virtual assets. Gibraltar’s principles for licensing are however less prescriptive and less restrictive than Hong Kong’s terms and conditions. For example, there is no restriction to providing services only to professional investors.

Following the implementation of the DLT Framework, Gibraltar’s Financial Services Commission (the **GFSC**) entered into a co-operation agreement with the Hong Kong Insurance Authority to promote information sharing on innovation and referrals of innovative firms seeking to enter the counterpart’s market.¹²³

According to PwC, Gibraltar ranked third in terms of the number of crypto hedge fund managers (behind the US and the UK, with Hong Kong coming in as joint 4th). Gibraltar is also the fourth most popular domicile for crypto hedge funds.¹²⁴ Of course, it is still early days, but Gibraltar has emerged as a leader in this space, not only through its progressive legislative efforts, but also the continued support and development of knowledge and skills relevant to this sector. An example is the establishment of the Gibraltar Association for New Technologies (**GANT**) comprised of Gibraltar’s leading law firms, accountancy firms and tech companies.¹²⁵ GANT is tasked with not only enhancing the development of blockchain and DLT, but also raising the profile of “new tech”. In Hong Kong, we have the Fintech Association of Hong Kong,¹²⁶ which has similar goals, however the association is independent, compared to Gibraltar’s association which was launched by the Government of Gibraltar.

AML/CTF Regulation

Gibraltar’s Proceeds of Crime Act 2015 was amended in 2018 to extend AML/CTF obligations to undertakings that receive proceeds in any form from the sale of tokenised digital assets whether on their own account or on behalf of another person. Licensed DLT Providers are also specifically required to comply with the Proceeds of Crime Act and related guidance issued by the Gibraltar Financial Services Commission.

The EU Fifth Anti-Money Laundering Directive (**5AMLD**) applies to Gibraltar and was transposed into the laws of Gibraltar via The Proceeds of Crime Act 2015 (Amendment) Regulations 2020. The 5AMLD brought service providers engaged in exchange services between virtual currencies and fiat currencies as well as custodian wallet providers into the AML/CTF regulatory regime. However, in 2017, Gibraltar had already regulated these activities. Under the laws of Gibraltar, everyone using DLT to store or transmit value belonging to another person was

¹²³

https://www.ia.org.hk/en/infocenter/press_releases/insurance_authority_and_gibraltar_financial_services_commission_sign_fintech_co-operation_agreement.html

¹²⁴ <https://www.pwc.com/gx/en/financial-services/pdf/pwc-elwood-annual-crypto-hedge-fund-report-may-2020.pdf>

¹²⁵ <https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/gibraltar#chaptercontent2>

¹²⁶ <https://ftahk.org>

already within the regulatory scope of the Fourth Anti-Money Laundering Directive. Gibraltar has not incorporated the provisions of 5AMLD relating to providers of crypto exchange services and providers of crypto custodian wallets since the providers of these activities are already subject to AML and CTF obligations as DLT Providers. This is demonstrative of how Gibraltar continues to stay ahead, as while a number of jurisdictions are now developing and enhancing crypto regulatory regimes and imposing / strengthening AML/CFT obligations (as is the case in Hong Kong, with the November 2020 FSTB proposal), Gibraltar has had a prescriptive regime in place since 2018. The DLT Provider's licensing process takes between a few months to one year and includes checks on internal AML/CFT procedures and controls and a risk assessment of the products offered, together with checks on individuals.¹²⁷

ICO Regulation

The DLT Regulations do not specifically provide for the regulation of ICOs, although they may fall within the scope of existing regulation of securities. Gibraltar issued proposals to regulate ICOs in March 2018.¹²⁸ The proposed regulations would cover the promotion and sale of crypto tokens, secondary market platforms and investment services relating to tokens and would regulate certain crypto-related activities conducted in or from Gibraltar. The proposed regime would cover virtual assets that fall outside the scope of the DLT Regulations and Gibraltar's financial services and securities laws.

Importantly, the GFSC has indicated that they do not want to and do not see a place for them as a regulator to prescribe what "good" looks like in token sales. The GFSC would rather allow the market of authorised sponsors to come up with different options of what a good ICO looks like.¹²⁹

In Hong Kong, a bespoke regulatory regime is not on the cards yet. Instead, regulators have taken a pragmatic approach, whereby the SFC determines the regulatory status of ICOs on a case-by-case basis depending on whether it has features of a traditional security. Where the tokens are considered "securities", any party dealing in or advising on the tokens, must be licensed by or registered with the SFC. This is of course a clear divergence from the regulatory position in Mainland China, yet is not anywhere near as progressive and proactive as efforts in Gibraltar, which places Hong Kong very much in the middle of the spectrum of regulatory approaches.

Activities which would be regulated under the proposals (if conducted in or from Gibraltar) include:

- i. the promotion, sale and distribution of tokens;
- ii. operating secondary market platforms trading in tokens; and

¹²⁷ <https://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/Moneyval-Mutual-Evaluation-Report-Gibraltar.pdf>

¹²⁸ <https://www.reuters.com/article/us-gibraltar-markets-cryptocurrencies-idUSKBN1FTIYN>

¹²⁹ <https://www.coindesk.com/gibraltar-take-market-driven-approach-ico-rules-officials-say>

- iii. providing investment and ancillary services relating to tokens.

The proposals would also introduce a requirement for an “authorised sponsor” of all publicly offered ICOs and would regulate the conduct of and impose obligations on authorised sponsors, secondary token market operators (i.e. virtual asset exchanges) and token investment and ancillary service providers.

The proposals would not however regulate token issuers or promoters, nor the tokens or technology underlying them. Instead, regulation will be effected by requiring authorised sponsors, crypto exchanges and service providers to comply with new regulations.

The aim of the proposed regulatory regime would be to mitigate the risks associated with the relevant activity. In the case of token-based crowd financing, this would require full and accurate disclosure of information, while secondary market platforms would be made subject to rules providing for orderly and proper conduct. Providers of investment services would be subject to competence requirements. GFSC will be the relevant supervisory authority for AML/CFT regulation, and the provisions of the DLT regulations will apply to firms covered by the new token regulations.

Promotion, Sale and Distribution of Tokens

The first limb of the proposed regulations would regulate the primary market promotion, sale and distribution of tokens that are not securities (which are already covered under existing securities legislation, as is the case in Hong Kong), outright gifts or donations, with the regulations extending to activities:

- i. which purport to be or imply that they are made from Gibraltar;
- ii. are intended to come to the attention of or be accessed by any person in Gibraltar;
- iii. are conducted by overseas subsidiaries of Gibraltar-registered legal persons (in such cases, the Gibraltar person will be liable); or
- iv. are conducted by overseas agents and proxies acting on behalf of Gibraltar-registered legal persons, or on behalf of natural persons ordinarily resident in Gibraltar (in such cases, the Gibraltar person will be liable).

According to the proposals, these tokens are typically those referred to as utility or access tokens which offer commercial products or services (which may not exist at the time of the token sale). Tokens that function solely as decentralised virtual currency (e.g., Bitcoin) or as central bank-issued digital currency (CBDCs) will be excluded from this limb of the regulations. However, hybrid tokens (which have an underlying economic function that is both virtual currency and something else) will be caught.

Unless further specifics are included in the proposed legislation or guidance, the current proposals do little to create clarity as to which tokens will be covered by the new legislation and existing securities laws, respectively and which will remain unregulated. The regulatory treatment of an ICO offering will thus still require an analysis of the nature of the rights attached to the tokens and their intended use. From a European perspective, the closest equivalent to the US concept of a

security, is probably a unit in a collective investment scheme. To date, there is no guidance as to how that concept applies to an ICO. It is not clear from the Gibraltar proposals whether they will cover all “utility tokens” irrespective of whether they can be traded in the secondary market. We can compare this to Hong Kong where currently virtual assets are regulated to the extent they fall within the definition of a “security”, but there has been little guidance from the regulators on the characteristics that are likely to make a token issued in an ICO, for example, an interest in a collective scheme.

Disclosure Rules

The proposed regulations on the promotion, sale and distribution of tokens will require adequate, accurate and balanced disclosure of information to enable anyone considering purchasing tokens in the primary market to make an informed decision. The regulations may prescribe what, as a minimum, constitutes adequate disclosure, and in what form disclosures are made (e.g., in a key facts document not exceeding 2 pages). The Gibraltar FSC may publish guidance on the disclosure rules from time to time.

Financial Crime Provisions

Undertakings that receive, whether on their own account or that of another person, proceeds in any form from the sale of tokens were brought within the scope of the Proceeds of Crimes Act 2015 (**POCA**) by an amendment which took effect in March 2018. Token issuers are thus already under a statutory obligation to perform AML and CTF checks on token purchasers.

Authorised Sponsors

The proposed regulations will establish a regime for the authorisation and supervision of token sale sponsors (authorised sponsors) who will be responsible for ensuring compliance with this limb of the regulations. An authorised sponsor will need to be appointed in respect of every public token offering promoted, sold or distributed in or from Gibraltar. Authorised sponsors may be appointed by the Gibraltar promoter or by organisers of the offering, wherever located.

Authorised sponsors will be required to have knowledge and experience of ICOs and mind and management in Gibraltar. They will be allowed to delegate some of their work to others, including offshore parties, but will remain directly accountable to GFSC for the actions of their delegates.

Codes of Practice

Under the proposed regime, authorised sponsors will be required to have in place one or more codes of practice relating to offerings they sponsor. Authorised sponsors are considered to be in the best position to determine best practice for the offerings they sponsor and will be free to apply different codes to different categories of tokens and offerings. Codes of practice may cover matters such as methods for applying and distributing sale proceeds.

A code of practice will have to be incorporated in authorised sponsors’ agreements with their ICO clients. Submission of codes of practice will form part of the

application process for an authorised sponsor licence. Prior reporting of amendments to codes of practice will be required and will be treated in the same way as other major business changes.

It is proposed that regulations would specify principles governing the content of codes of practice. Authorised sponsors will be free, subject to approval, to set their own methodologies for implementing the principles.

Registers of Authorised Sponsors, Codes of Practice, Sponsors' Clients and Tokens

GFSC will establish and maintain a public register of authorised sponsors and their codes of practice (past and present).

GFSC will add to the public register the following details of public offerings provided by authorised sponsors of public offerings they are engaged in:

- i. the client(s) for whom they act;
- ii. the token(s) included in the offering;
- iii. the code of practice applicable to the offering; and
- iv. any interest they, and connected persons, have in the tokens offered.

New Controlled Activity and Offence

A new controlled activity of being an authorised sponsor is proposed and it will be an offence to promote, sell or distribute tokens in or from Gibraltar without compliance with:

- i. the requirement for an authorised sponsor;
- ii. the requirement for a current entry on the public register;
- iii. specified disclosure obligations; and
- iv. relevant provisions of POCA, where applicable.

The promotion, sale and distribution of a public token offering may only be conducted once, and while, the offering appears on the register.

Secondary Market Activities

The proposals include regulation of secondary market platforms operated in or from Gibraltar that are used for trading tokens and, to the extent not covered by other regulations, their derivatives. The regulations aim to ensure that the activities of these markets are fair, transparent and efficient and that organised trading occurs only on regulated platforms.

The proposed regulations will set out requirements for:

- i. disclosure to the public of data on trading activity;
- ii. disclosure of transaction data to GFSC; and
- iii. specific supervisory actions concerning tokens and positions on token derivatives.

These regulations will cover secondary market trading of all tokenised digital assets including virtual currencies and will be modelled, to the extent appropriate, on market platform provisions under MiFID 2 and the Markets in Financial Instruments and Amending Regulation (**MiFIR**).

Authorised Secondary Token Markets

The proposals include adding a new controlled activity of operating a secondary market platform used for trading tokens and their derivatives. GFSC will authorise and supervise secondary token market operators and maintain a public register of such operators.

Investment and Ancillary Services relating to Tokens

The proposed legislation would include a new controlled activity of providing investment and ancillary services relating to tokens in or from Gibraltar and, to the extent not covered by other regulations, their derivatives.

This limb of the regulations is intended to cover advice on investments in tokens, virtual currencies and central bank-issued digital currencies, including:

- i. generic advice (setting out fairly and in a neutral manner the facts relating to token investments and services);
- ii. product-related advice (setting out in a selective and judgemental manner the advantages and disadvantages of a particular token investment and service);
- iii. and personal recommendation (based on the particular needs and circumstances of the individual investor).

This limb of the regulations will be modelled on similar provisions under the MiFID.

The proposals are planned to be implemented through amendments to Gibraltar's Financial Services (Investment and Fiduciary Services) Act 1989.

EU PROPOSALS

EU Proposals – a Comprehensive Framework for Digital Assets

The EU's proposed framework for crypto assets was announced on 24 September 2020 as part of the European Commission's Digital Finance Package (which aims

to enhance the competitiveness of the fintech sector in the EU),¹³⁰ and seeks to regulate crypto assets that currently fall outside the scope of the EU's regulatory regime to provide for a single licensing regime across all member states.¹³¹ The proposed framework is particularly notable given that, if adopted, it will create the "most significant" regulated space for cryptocurrencies in the world,¹³² in addition to subjecting stablecoin issuers to enhanced regulation.

Crypto assets are defined in the MiCA as "a digital representation of value or rights which may be transferred and stored electronically, using DLT or similar technology".

Generally, the MiCA will apply to any cryptoassets that are not already subject to EU regulation, meaning that cryptoassets which qualify as financial instruments (i.e. security tokens, which are already subject to EU financial services regulation) and e-money subject to the EU's E-Money Directive will fall outside the scope of the MiCA. Crypto assets which qualify as deposits, structured deposits and securitisation will also not fall within the scope of the MiCA.

The MiCA will therefore regulate the likes of utility tokens (defined as a type of crypto asset intended to provide digital access to a good or service available on DLT and accepted only by the issuer of that token), stablecoins (also known as "asset-referenced tokens") and e-money tokens (which are tokens which do not fall within the definition of electronic money). Asset-referenced tokens are defined as a type of crypto asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one of several commodities or one or several crypto assets, or a combination of these assets. An e-money token is a crypto assets whose main purpose is use as a means of exchange and that purports to maintain a stable value by referring to the value of a single fiat currency. This would include USDC, the stablecoin issued by Circle which is backed by US dollars. There is also a specific mention of "significant" stablecoins, which will include "global stablecoins" (i.e. the likes of Facebook's Libra). The scope of the MiCA is further broadened with the catch-all definition of "other crypto assets", which is intended to cover all other crypto assets (such as Bitcoin and Ether) which are not covered by other regulatory regimes.

Which crypto asset services will be caught by the regime?

The scope of services which would be caught by the regulation are broadly similar to existing regulated activities under EU law and would include trading platform operators, custodial services, and exchange service providers (including crypto-to-crypto exchange; fiat-to-crypto and vice versa). It would also cover the placement of crypto assets, executing payment transactions in asset-referenced tokens and providing advice on crypto assets. The proposed regime would only allow crypto asset services to be provided by a legal person with a registered office in an EU Member State and that legal person would have to be authorised and licensed in an EU/EEA Member State as a crypto asset service provider. The authorisation will be "passportable", meaning that services can be provided throughout the EU, once

¹³⁰ <https://www.sygna.io/blog/what-is-mica-markets-in-crypto-assets-eu-regulation-guide/>

¹³¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020PC0593>

¹³² <https://www.coindesk.com/eu-proposes-full-regulatory-framework-for-cryptocurrencies>

authorised in a Member State. In order to obtain a crypto asset service provider licence, an entity will need to meet requirements similar to those applicable to financial service providers including capital requirements, organisational and conduct requirements.

Crypto Issuers

The MiCA adopts a broad definition of “any legal person who offers to the public any type of crypto assets or seeks the admission of crypto assets to a trading platform for crypto assets”. Certain requirements will be imposed on those falling within the definition of an “issuer”, including that:

- i. an issuer must be a legal entity. The requirement to establish a legal entity to provide crypto asset services is aimed at providing investors with an identifiable party against which they may seek redress;
- ii. issuers will also be subject to minimum disclosure requirements (i.e. they must publish a whitepaper, which satisfies certain minimum content requirements (similar to the requirements under the EU Prospectus Regulation) and complies with the requirement that disclosures are fair, clear and not misleading). In the case of issuers of asset-referenced tokens (stablecoins), they will be further be required to seek authorisation. The MiCA will impose liability on the issuer for damages in the case of failure to meet the requisite standards.
- iii. issuers must also comply with the requirements set out in Article 13 of the MiCA (which broadly relates to conduct and communication requirements, conflicts of interests and security).

In the case of issuers of stablecoins (“**asset-referenced tokens**”) or e-money tokens, the requirements are more far-reaching. Issuers of e-money tokens and asset-referenced tokens will have to be established in the EU. Issuers of e-money tokens will also be required to be authorised as an e-money issuer under the E-money Directive and issuers of stablecoins will be required to be authorised under the MiCA. Exemptions are available from the authorisation requirements for both e-money token issuers and asset-referenced token issuers for small-scale offerings of up to EUR 5 million within 12 months and offerings solely to qualified investors.

There is no requirement for issuers of general crypto assets to be established in the EU.

MiCA will also introduce more stringent requirements and enhanced supervision requirements for “significant” asset-referenced tokens and “significant” e-money tokens. Issuers of significant e-money or asset-referenced tokens will be subject to a higher capital requirement of up to 3% of reserve assets and will have to put in place a liquidity management policy. The assessment of whether a particular token is significant will be made by the European Banking Authority having regard to factors such as a market capitalisation or value of at least EUR 1 billion, having at least 2 million customers and use in at least seven EU member states.

Territorial Application

If adopted, MiCA would apply across the EU to all member states and would be directly applicable, meaning implementation at a national level would not be required. In addition, firms outside the EU would be impacted, to the extent that they do business within the EU. Issuers seeking to issue stablecoins or e-money tokens in the EU would therefore be required to be established in the EU and be duly authorised.

Comparison to efforts elsewhere and what the Proposals mean for the future of the “crypto” race

It has been tentatively suggested that the proposals will take up to four years to be formally adopted in EU legislation.¹³³ This is taking into account the legislative process (which may take up to one or two years) and an 18-month transition period for authorisation, as indicated in the proposals. There are a handful of European nations which have pushed ahead with innovative frameworks to capture the opportunities in the crypto sphere, however there is no over-arching regulatory regime, which is in some ways at odds with the cross-border nature of many crypto businesses. This was a concern for some startups in the crypto space, with some relocating from Europe to more “favourable” regulatory spaces in Asia.¹³⁴ This fragmented approach in the EU was one of the key motivating factors behind the proposals (and in particular the “passporting provision”), as identified by the Vice President of the European Commission, who indicated that fintechs are facing many barriers to exploring the full potential of the single market.¹³⁵ Looking ahead, one of the key benefits of the proposed framework would therefore be access to a new EU single market for crypto assets.

A broadly similar picture has emerged in Asia Pacific. We have seen a patchwork of regulatory approaches evolve, ranging from Mainland China’s prohibitive approach and outright ban (in some areas) to Japan’s more progressive legislative efforts, which have been welcomed by the crypto industry. Hong Kong lies somewhat in the middle, as regulators try to strike a balance between risk management and investor protection on the one hand and ensuring innovation is not stifled on the other. Therefore, generally speaking, those operating in the crypto sphere in the EU and Asia Pacific face the same main challenge – knowing, understanding and complying with the restrictions, requirements and obligations from jurisdiction-to-jurisdiction. Of course, Asia Pacific is not comparable to the European Union (given there is no comparable economic and political union (of that scale) in the APAC region), however that is not to say that a coordinated or harmonised effort is not possible. For example, this is, to a more limited extent, what the FATF recommendations are seeking to accomplish.

As for how the legislative efforts in Europe and Asia Pacific differ, the main distinction is pace. Broadly speaking, regulatory efforts in Asia have gained momentum over the past few years,¹³⁶ and we have seen APAC emerge as a

¹³³ <https://www.sygna.io/blog/what-is-mica-markets-in-crypto-assets-eu-regulation-guide/>

¹³⁴ <https://www.skalex.io/crypto-europe/>

¹³⁵ <https://www.ledgerinsights.com/eu-planning-single-market-for-blockchain-crypto-asset-libra/>

¹³⁶ <https://techwireasia.com/2020/12/apac-leads-the-way-in-regulating-cryptocurrency-markets/>

“hotbed” for digital innovation.¹³⁷ Many queried whether we would see this momentum replicated in Europe and it seems that with the EU proposals, there is real potential. On the other hand, concerns have been raised that the EU proposals favour incumbent financial institutions¹³⁸ (over fintech startups) and so it remains to be seen whether the framework will strike the right balance between fostering innovation and mitigating risks, a balance which can all too easily be thrown off by over-regulation or barriers to entry set too high. This is a familiar concern in Hong Kong, a concern which has re-emerged in light of the FSTB proposals, particularly the proposed prohibition on virtual asset exchanges servicing retail investors. Co-founder of the Bitcoin Association of Hong Kong, Leo Weese, has complained that the move would “overshoot” the Hong Kong Government’s goal of promoting innovation and financial inclusion.¹³⁹

RECENT MARKET DEVELOPMENTS

PayPal

PayPal recently launched services allowing US users to buy, sell and hold cryptocurrencies directly through their PayPal accounts. By way of an update, it has been forecast that PayPal’s overall revenue will increase by 20%, with earnings of approximately US\$2 billion from its bitcoin business alone by 2023.¹⁴⁰ Interesting, and demonstrative of the scale of interest in PayPal’s newest feature, is that bitcoin traders have been found to be using the PayPal app three times as much as non-bitcoin users, with the former having significantly higher cash balances in their PayPal digital wallets compared to other users.¹⁴¹

Hong Kong’s most recent development (the proposed retail ban) is very much at odds with PayPal’s latest move. The recent licensing of crypto exchange a OSL Digital Securities (a platform which will be restricted under the terms of its licence to serving institutions and professional investors) is a case in point. Regulation is causing Hong Kong’s crypto market to shift away from the retail market and this will only increase when the FSTB’s proposed regime for licensing exchanges which trade virtual assets that are not securities comes into force. The benefit of regulation is that it can give institutional investors the comfort they need to enter the crypto market.

DBS Digital Exchange

Southeast Asia’s largest lender (**DBS**) announced on 10 December 2020 that it would be setting up the DBS Digital Exchange (the first digital exchange for trading fiat money and cryptocurrencies with backing from a traditional bank). The

¹³⁷ <https://s3.amazonaws.com/documents.lexology.com/bbff834d-9cdf-49eb-b08f-804c8c79b935.pdf?AWSAccessKeyId=AKIAVYILUYJ754JTDY6T&Expires=1611208627&Signature=TwgLMkBcwSymAL%2BcivCt1BXWOG8%3D>

¹³⁸ <https://www.ashurst.com/en/news-and-insights/legal-updates/10-things-you-need-to-know-about-mica-europes-proposals-for-regulating-crypto-assets/>

¹³⁹ <https://www.coindesk.com/hong-kong-atms-must-be-excluded-from-coming-aml-regulations-group-says>

¹⁴⁰ <https://news.bitcoin.com/paypal-to-earn-2-billion-in-revenue-from-its-bitcoin-business-says-analyst/>

¹⁴¹ <https://news.bitcoin.com/paypal-to-earn-2-billion-in-revenue-from-its-bitcoin-business-says-analyst/>

announcement followed its receipt of in-principle approval by the Monetary Authority of Singapore (MAS) recognising the DBS Digital Exchange as a Recognised Market Operator.¹⁴² The DBS Digital Exchange will provide a regulated platform for the issuance and trading of digital tokens back by financial assets; cryptocurrency trading and exchange services between four fiat currencies (including HKD) and four of the “most established” cryptocurrencies (bitcoin, ether, bitcoin cash and XRP) and digital custody services.¹⁴³ The DBS Digital Exchange will only offer services to institutional investors and accredited investors. The entry of traditional banks and payment services platforms into the crypto sphere is an indication that traditional players are recognising the potential of cryptocurrencies. This is also evident when looking at the surging levels of institutional interest, with institutional investors injecting around US\$429 million into crypto funds and projects for the week ending 7 December 2020 (the second highest record to date).¹⁴⁴ DBS’ move is also an indication that regulators in the Asia Pacific region are becoming increasingly confident handling crypto and crypto-related trading.¹⁴⁵

DBS’ announcement came just before Hong Kong’s licensing of OSL Digital Securities which has reportedly also applied for a digital asset licence with the Monetary Authority of Singapore under the Payment Services Act.¹⁴⁶

Bitcoin Funds and Institutional Investment

In a further suggestion that institutional interest in crypto is on the rise, BlackRock, the world’s largest asset manager (with around US\$7.8 trillion in AUM) is reported to be looking at giving two funds the “go-ahead” to invest in bitcoin futures (according to prospectus documents filed with the US SEC on 20 January 2021).¹⁴⁷ This would be BlackRock’s first step into the crypto market, however there have been indications that the move was under consideration. In November 2020, BlackRock’s CIO for Fixed Income stated that crypto was “here to stay” and could even replace gold to a large extent. This sentiment was echoed by BlackRock’s CEO, Larry Fink, who, in 2020, acknowledged the potential for bitcoin to turn into a global market asset.¹⁴⁸ According to a recent report (published on 21 January 2021) by trading platform eToro, which quizzed 25 big institutions in the third quarter of 2020, more and more asset managers (even the most-risk averse, such as pension funds and endowments) are looking at crypto as an asset class, with many suggesting that the crypto market had matured considerably over the past two years, with the time now being right to get involved.¹⁴⁹

This trend is somewhat recognisable in Hong Kong too, where we have seen OSL receive its licence and the first approved crypto fund, Arrano, launch in April 2020 targeting institutional investors. Whether we will see more institutional investors

¹⁴² https://www.dbs.com/newsroom/dbs_digital_exchange

¹⁴³ https://www.dbs.com/newsroom/dbs_digital_exchange

¹⁴⁴ <https://www.cnn.com/2020/12/10/singapore-bank-dbs-to-launch-digital-exchange-as-crypto-demand-soars.html>

¹⁴⁵ <http://www.fundsglobalasia.com/news/dbs-gets-go-ahead-for-digital-exchange>

¹⁴⁶ <https://www.finews.asia/finance/33425-hong-kong-s-first-licensed-crypto-platform-goes-live>

¹⁴⁷ <https://www.coindesk.com/blackrock-give-two-funds-go-ahead-to-invest-in-bitcoin-futures>

¹⁴⁸ <https://www.coindesk.com/blackrock-give-two-funds-go-ahead-to-invest-in-bitcoin-futures>

¹⁴⁹ <https://www.coindesk.com/etoro-survey-finds-pensions-and-endowments-are-finally-waking-up-to-crypto>

move into the crypto space in Hong Kong remains to be seen, however we are most certainly entering a “new era of growth”.¹⁵⁰

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¹⁵⁰ <https://coingeek.com/institutional-investment-broker-osl-receives-digital-asset-trading-license-from-hk-regulator/>