

## What You Should Know about Bitcoin and Other Cryptocurrencies

In early 2018, the Securities and Future Commission (“SFC”) commenced its first regulatory action against initial coin offering (“ICO”) to the public, after sending letters to seven cryptocurrency exchanges reminding them of the need to obtain licence for trading cryptocurrencies which fall under the definition of “securities”.

In the following, we will discuss some of the issues surrounding Bitcoin and other cryptocurrencies.

### *1. Customs and Excise Department*

In April 2014, the Customs and Excise Department (“C&E”) issued a statement clarifying that Bitcoin and other similar virtual currencies are not considered money, and hence are not regulated by C&E. C&E particularly warned licensed money service operators (“MSO”) and applicants for MSO licences that the MSO licence does not give them any form of recognition or permission to engage in cryptocurrencies trading or other relevant activities in Hong Kong.

Notwithstanding the above, persons or entities offering services for trading and exchange of cryptocurrencies may not be absolved from applying for a MSO licence. Currently, a person who operates or wishes to operate a money service is required to apply for a MSO licence. As money service includes money changing service and money remittance service, a cryptocurrencies exchange which receives or sends fiat currency from or to places outside of Hong Kong for the exchange of cryptocurrencies is required to have a MSO licence.

Therefore, parties interested in providing cryptocurrency trading services should review their business activities to ascertain whether a MSO licence is needed. To date, a major token exchange in Hong Kong, Gatecoin, has obtained a MSO licence.

### *2. SFC*

SFC issued two circulars on 5 September 2017 and 11 December 2017 respectively, warning that certain ICOs might fall under the definition of “securities” and “futures”, and thus subject to an extensive regulatory regime.

Securities include shares, debentures and collective investment schemes. Whether a financial product falls under the definition of “securities” depends on its nature and rights attached rather than how it is named.

(a) Shares

SFC considers that if the coins offered in a specific ICO carry equity interests in a corporation, such coins might be regarded as shares. Equity interests include rights to receive dividends, or entitlement to surplus assets in the event of winding up, etc.

(b) Debenture

SFC also reminds the public that a coin which acknowledges a debt and liability owed by the issuer to the coin holder might be considered as a debenture, thus falling under the definition of “securities”.

For instance, if an issuer undertakes to pay to a coin holder a sum with interests upon redemption of the coin or a maturity date, such coin might be considered debenture by SFC.

(c) Collective Investment Scheme

A collective investment scheme is also under the regulatory regime of SFC, and has the following features: -

- (i) it must involve an arrangement in respect of property;
- (ii) participants do not have day-to-day control over the management of the property;
- (iii) the property is managed as a whole by or on behalf of the person operating the arrangements, and/or the contributions of the participants and the profits or income from which payments are made to them are pooled; and
- (iv) the purpose or effect of the arrangement is for participants to participate in or receive profits, income or other returns from the acquisition or management of the property.

Unless specifically exempted under section 103 of the Securities and Futures Ordinance (“SFO”), an advertisement or invitation to a collective investment scheme has to be authorized by the SFC.

In March 2018, the SFC commenced regulatory action against Black Cell Technology Limited (“**Black Cell**”), which was promoting an ICO for funding the development of a mobile application. Under the ICO, holders of the coins would be entitled to redeem equity shares of Black Cell. As the ICO is accessible by the Hong Kong public through Black Cell’s website, SFC considered that it might constitute collective investment scheme offered to the Hong Kong public.

Ultimately, Black Cell agreed to halt its ICO to the Hong Kong public and unwind all relevant transactions.

### (d) Futures

SFC also reminded investors that futures contracts relating to Bitcoins or other cryptocurrencies on foreign exchanges, e.g. U.S. CME and Cboe exchanges, which are available to the Hong Kong public through intermediaries that are members of these exchanges, are futures contracts subject to regulation by SFC.

### (e) Further Regulations

On 1 November 2018, the SFC issued a circular revealing its updated policy concerning licensing of regulated activities. The new policy is to strengthen control over intermediaries managing and distributing cryptocurrencies portfolios and funds.

Currently, unless an entity is an authorized institution (e.g. bank, restricted license bank or deposit taking company), it has to be licensed to carry out regulated activities, which include the following:-

- (i) Type 1: Dealing in securities;**
- (ii) Type 2: Dealing in futures contracts;**
- (iii) Type 3: Leveraged foreign exchange trading;
- (iv) Type 4: Advising on securities;**
- (v) Type 5: Advising on futures contracts;**
- (vi) Type 6: Advising on corporate finance;
- (vii) Type 7: Providing automated trading services;
- (viii) Type 8: Securities margin financing;
- (ix) Type 9: Asset management;**
- (x) Type 10: Providing credit rating services;
- (xi) Type 11: Dealing in OTC derivative products or advising on OTC derivative products; and
- (xii) Type 12: Providing client clearing services for OTC derivative transactions.

The new circular states that Type 9 licensees managing portfolio(s) which invests solely or partly in virtual assets; or Type 1 licensees managing and distributing funds in Hong Kong which solely invest in non-securities or futures virtual assets, might be subject to specific licensing conditions if such licensee(s) manage or plan to manage portfolios with the following features:-

- (i) a stated investment objective to invest in virtual assets; or
- (ii) an intention to invest 10% or more of the gross asset value of the portfolio in virtual assets (“**regulated portfolios**”).

The most notable licensing condition is that such licensees have to undertake not to allow anyone other than professional investors as defined under the SFO to invest into any regulated portfolios under their management.

Meanwhile, SFC has also launched a voluntary scheme whereby cryptocurrency exchanges may enroll into a sandbox for SFC to observe its day to day operations. SFC would use the information gathered to tailor make licensing conditions for the specific exchange and might upon such exchange’s undertaking to comply with the same, grant it a licence.

### **3. Conclusion**

It appears that certain ICOs are by nature securities and futures offerings. While electing to raise funds by coin offering might not necessarily be a deliberate attempt to get around existing rules, it would be prudent for an issuer to first consult with the lawyers and/or SFC to seek their views on its cryptocurrency related products, to avoid any undesirable regulatory actions taken by SFC.

If you have any queries regarding this article or any other questions relating to Bitcoin and other cryptocurrencies, experienced solicitors in our Corporate and Commercial Department will be happy to assist you.

Prepared in January 2019

#### **HONG KONG OFFICE**

23/F, Shui On Centre  
6-8 Harbour Road, Hong Kong  
Telephone: (852) 2522 2041/(852) 2525 9161  
Facsimile: (852) 2845 9282/(852) 2845 2928  
E-mail: [post@fclklaw.com.hk](mailto:post@fclklaw.com.hk)

#### **SHANGHAI REPRESENTATIVE OFFICE**

47/F, Hong Kong New World Tower,  
No. 300 Huai Hai Zhong Road., Shanghai, China 200021  
Telephone : (8621) 6335 3376 / (8621) 5116 2883