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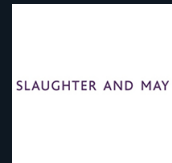
Country Comparative Guides 2024

Hong Kong

Blockchain

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This country-specific Q&A provides an overview of blockchain laws and regulations applicable in Hong Kong.

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Hong Kong: Blockchain

1. Please provide a high-level overview of the blockchain market in your jurisdiction. In what business or public sectors are you seeing blockchain or other distributed ledger technologies being adopted?

Hong Kong has embraced blockchain and distributed ledger technology ("DLT"), being listed by the Worldwide Crypto Readiness Report as the most "crypto-ready" jurisdiction in the world in 2023, ranking in the top three in terms of the number of cryptocurrency ATMs proportional to geographical size.

In October 2022, the Financial Services and the Treasury Bureau of the Hong Kong Government ("FSTB") published a policy statement ("FSTB Policy Statement") explaining its approach to and vision for the development of a vibrant ecosystem for virtual assets ("VAs") in Hong Kong, illustrating the Hong Kong Government's proactive approach to embracing future opportunities in the sector. Following the publication of the FSTB Policy Statement, as of February 2023, over 80 VA-related companies have expressed interest in establishing a presence in Hong Kong. As of 30 September 2024, there are 17 pending virtual asset trading platform applications and 2 operators of virtual asset trading platforms that have been formally licenced by the Securities and Future Commission ("SFC").

Several major blockchain-focused conferences have taken place in Hong Kong in recent years. The inaugural Hong Kong Web3 Festival 2023, one of the largest VA-focused conferences in Hong Kong's history, featured more than 300 industry leaders, project founders, investors, regulatory agency representatives and experts, coming together to discuss key market dynamics and trends relating to Web3 technologies. The annual Hong Kong FinTech Week 2023, organised by the FSTB and Invest HK (the Hong Kong Government department responsible for foreign direct investment) and co-organised by the Hong Kong Monetary Authority ("HKMA"), the SFC and the Insurance Authority ("IA"), also covered Web3 technologies, amongst other frontier technological developments in fintech. The event amassed over 800 speakers and 700 exhibitors.

According to a June 2020 report by the FSTB, in 2019 blockchain firms accounted for 39% of the new fintech

firms brought into Hong Kong by Invest HK. Of these new blockchain firms: 45% were enterprise solutions using blockchain technologies; 27% were trading platforms for digital assets; 14% were involved in custody of digital assets; 9% in trade finance settlement; and 5% in security tokens. Invest HK found that Hong Kong is home to over 1000 fintech companies as of January 2024, which represents a significant increase from 230 in 2017, 600 in 2019 and 800 in 2023.

Fintech and digital assets continue to be areas of particular focus for the Hong Kong Government and the city's key financial regulators, the Hong Kong Monetary Authority ("HKMA"), the Securities and Futures Commission and the Insurance Authority. In August 2024, the SFC launched Project Ensemble Sandbox, which aims to improve the interoperability between the traditional financial ecosystem, the new financial ecosystem built on blockchain and among financial institutions. Its goal is to formulate a common standard for the settlement of tokenised assets in Hong Kong and globally. See question 4 for further details.

Outside of the finance industry, blockchain has been implemented in various other contexts in Hong Kong, ranging from non-fungible tokens ("NFTs") tokenising artifacts from museum collections to DLT-based auditing and data management for aviation assets.

2. Please outline the principal legislation and the regulators most relevant to the use of blockchain technologies in your jurisdiction. In particular, is there any blockchain-specific legislation or are there any blockchain-specific regulatory frameworks in your jurisdiction, either now or envisaged in the short or mid-term?

On 1 June 2023, amendments to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) ("AMLO") and the SFC's "Guidelines for Virtual Asset Trading Platform Operators" ("VATP Guidelines") came into effect, reflecting a major development in Hong Kong's implementation of VA-specific regulation. However, blockchain and DLT invariably engage existing legal and regulatory regimes to some extent, and the SFC and the HKMA have indicated they will follow a "same risk, same regulation" approach in regulating crypto-

assets. On 17 July 2024, the FSTB and the HKMA jointly released the consultation conclusions for the legislative proposal to implement a regulatory regime for stablecoin issuers. While detailed drafting has yet been issued, a bill is intended to be introduced to the legislature in late 2024. Furthermore, on 8 February 2024, FSTB issued a consultation paper to regulate over-the-counter ("OTC") trading of VA ("VA OTC Regime"). The consultation concluded in April 2024.

Regulation of virtual asset trading platforms

There are now two licensing regimes in Hong Kong applicable to virtual asset trading platforms ("VATPs"), which operate side-by-side. For "security" tokens, the SFC's licensing regime applies to VATP operators offering trading services in at least one "security" as defined under the Securities and Futures Ordinance (Cap. 571) ("SFO"), and permits them to grant access to retail investors subject to additional safeguards (such as requiring tradeable VAs to be "large-cap" and pre-approved by the SFC and ensuring that retail investors have the requisite knowledge of VAs and their associated risks). For non-security tokens, the AMLO regime mandates licensing for VATP operators offering trading services in such tokens (including, e.g., Bitcoin and Ether). The SFC expects all VATP operators to be dually licensed under both the SFO and AMLO if they operate (or actively market to investors) in Hong Kong. Offering such services in Hong Kong without the required licences is prohibited.

Under the transitional arrangements, pre-existing VATPs (i.e., VATPs operating in Hong Kong immediately before 1 June 2023) would benefit from a "non-contravention period" which allowed them to continue their operations in Hong Kong until 31 May 2024, after which they must be licensed or deemed licensed to continue such operations. Pre-existing VATPs would be deemed licensed if they had submitted a licence application by 29 February 2024, unless and until their licence applications are withdrawn or refused. On the other hand, non-pre-existing VATPs (i.e. VATPs not operating in Hong Kong immediately before 1 June 2023) would not benefit from the non-contravention period or the deeming arrangements, and must wait until their licence applications are approved before commencing operations in Hong Kong.

As of 30 September 2024, only two firms – OS Digital Securities Limited ("OSL") and Hash Blockchain Limited ("HashKey") – are licensed by the SFC as VATP operators.

Following the publication of the JPEX Statements (see question 8 for more detail) and as part of SFC's efforts to

disseminate information on VATPs in a clear, transparent and timely manner, the SFC maintains several lists of VATPs on its website, including: (i) licensed VATP operators, (ii) VATP operator applicants, (iii) removed VATP operator applicants, (iv) closing-down VATPs, (v) deemed licensed VATPs and (vi) suspicious VATPs.

Licensed firms (whether trading security or non-security tokens) must comply with the new VATP Guidelines which set out requirements relating to, among other things, token due diligence (including the creation of a token admission and review committee), retail investor protection measures (such as measures to compensate clients for potential loss of VAs from storage), client asset custody (such as use of "cold storage" i.e. offline facilities for client VAs), fitness and properness, financial soundness, supervision and internal controls.

In addition, licensees must comply with statutory anti-money laundering ("AML") and counter-terrorist financing ("CTF") obligations, such as requirements in relation to customer due diligence and record-keeping, as described in Chapter 12 of the SFC's Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers) dated June 2023 (see also question 6). VATPs must also comply with the "Travel Rule", which requires VATPs to gather, and make available, certain key information for sanctions screening and transaction monitoring.

Regulation of over-the-counter trading of virtual assets

In a consultation paper published by the FSTB on 8 February 2024, it noted that recent fraud cases involving OTC VA money changers actively promoting products and services to the Hong Kong public (see SFC's JPEX Statements in question 8) highlighted the need for VA OTC services to be regulated. Recognising the role that VA OTC services play in channelling the investing public's funds as well as their significant presence in the Hong Kong market, the FSTB found a strong need to bring such operations into the regulatory remit in order to protect investors and to mitigate money laundering and terrorist financing risks.

The proposed VA OTC regime would require any person who conducts a business in providing spot trade services of any VA for money in Hong Kong, or actively markets the provision of such services, to be licensed. All VA OTC services, irrespective of whether the services are provided through a physical outlet or other platforms, would be caught.

The consultation period ended on 12 April 2024. As of 30

September 2024, no legislative proposals have yet been published.

Regulation of stablecoin issuers

Under the proposed licensing regime for stablecoin issuers, those who issue a fiat-referenced stablecoin ("FRS") in Hong Kong, issue an HKD-referenced stablecoin or actively market its FRS issuance to the Hong Kong public, would be subject to licensing. Key licensing criteria will include: (i) the full backing of issued FRS by reserve assets; (ii) minimum paid-up share capital of HK\$25 million or 1% of par value of issued FRS (whichever is higher); and (iii) certain localisation requirements. Offering of FRS in Hong Kong may only be conducted by a specified group of regulated entities (including authorized institutions, licensed corporations and licensed virtual asset trading platforms).

To allow institutions with plans to issue stablecoin in Hong Kong to conduct testing on their operational plans, the HKMA has introduced a stablecoin issuer sandbox in March 2024. As of July 2024, the sandbox includes three participants. Those who are interested to join the sandbox can submit their enquiries and applications to the HKMA. Upon the effective date of the new regime, pre-existing FRS issuers that are conducting FRS issuance activities with a substantial and meaningful presence in Hong Kong may continue to operate for 6 months, on condition they have submitted a licence application to the HKMA within the first three months of the commencement of the new regime. Pre-existing FRS issuers that do not submit a licence application within this timeframe must close down its business in an orderly manner by the end of the 4th month of the commencement of the regime.

The HKMA indicated that a bill to implement the regulatory regime is proposed to be introduced to the legislature in late 2024.

Regulation of other VA/fintech-related activities

Hong Kong's key financial regulators are also active more broadly in regulating fintech-related activities. As of 31 August 2024, the HKMA has granted licences to eight virtual banks in Hong Kong. From a legal and regulatory perspective, such virtual banks are subject to the same set of supervisory requirements (albeit with some adaptations) as conventional banks, under the HKMA's risk-based and technology-neutral approach.

The IA has granted four virtual insurance company licences under its Fast Track pilot scheme for applications for authorizations of new insurers owning

and operating solely digital distribution channels. Similar to virtual banks, virtual insurers are subject to the same set of supervisory requirements applicable to conventional insurers (including solvency, capital, and local asset requirements).

The SFC has issued several statements and circulars concerning cryptocurrencies and other VAs. These include, among others, a statement on a regulatory framework for VA portfolio managers, fund distributors and trading platform operators issued on November 2018 and a joint circular issued with the HKMA in December 2023 (the "SFC-HKMA 2023 Circular") setting out updated guidance for intermediaries wishing to engage in various VA-related activities. See the responses to questions 5-10 below for further detail.

3. What is the current attitude of the government and of regulators to the use of blockchain technology in your jurisdiction?

The Hong Kong Government and key Hong Kong regulators have each launched various initiatives aimed at promoting the use of blockchain and DLT, while also expressing caution as to the risks involved. The FSTB Policy Statement states that "[a]s an international financial centre, Hong Kong is open and inclusive towards the global community of innovators engaging in VA businesses" and notes that the Hong Kong Government would "put in place timely and necessary guardrails, so that VA innovations can thrive in Hong Kong in a sustainable manner".

The Hong Kong Government and key regulators have themselves also been active in developing and piloting blockchain technologies.

For example, in the green finance sector, the HKMA and the Bank for International Settlements ("BIS") Innovation Hub Hong Kong Centre ("BIS Hub") have in August 2021, announced the launch of Project Genesis 1.0, which explored the tokenisation of green bonds to enable investment in small denominations, combined with real-time tracking of environmental outputs. The project developed two prototype digital platforms to streamline the bond issuance process and improve transparency of the use of proceeds. The platforms combined smart contracts, blockchain, Internet of Things and digital assets and allowed retail investors to continuously track coupon payments and the environmental impact of the financed projects. Following the successful conclusion of Project Genesis 1.0, in October 2022, Project Genesis 2.0, which involved developing prototypes for tracking, delivering, and transferring digitised carbon forwards,

was also successfully completed.

In February 2023, the Hong Kong Government issued the world's first tokenised governmental green bond. All coupon payment, settlement of trading and redemption are to be conducted through an online tokenisation platform deploying DLT, marking a global milestone in the innovation of green finance and digitalisation of capital markets. To build on the successes of the first issuance, in February 2024, the Hong Kong Government issued its second batch of digital green bonds. The second issuance involved four currency tranches and incorporated multiple technological innovations and achieved new breakthroughs in terms of broadening investor participation and streamlining issuance process. It also represents the first multi-currency digital bond offering in the world.

The regulators' balanced approach is reflected in the HKMA's second whitepaper, published in October 2017 ("Second DLT Whitepaper"), which stresses the importance and value of DLT, while emphasising the attendant operational and legal / regulatory risks.

In its 2022 Annual Report, the HKMA stated that it is continuing to develop a roadmap of initiatives to further promote the adoption of fintech in the banking sector, will step up its efforts to research emerging technologies such as blockchain and will continue to work on developing a risk-based regulatory regime for stablecoins. The HKMA's generally supportive attitude to emerging technologies is informed by its broader Fintech 2025 strategy, which seeks to catalyse the financial sector to adopt various new technologies by 2025. Under the "Fintech 2025" strategy, key focus areas include: (i) encouraging full digitalisation of banks' operations and adoption of regtech; (ii) increasing Hong Kong's readiness relating to both wholesale and retail central bank digital currencies ("CBDC"); (iii) enhancing data infrastructure; and (iv) increasing the fintech talent pool.

The SFC has taken a similar position to balancing innovation and opportunities with risks. In a speech delivered in June 2023, the SFC's CEO noted that, although supportive of the development and use of emerging technologies, "[b]ringing virtual asset service providers into a well-balanced regulatory fold is the only pathway to embrace innovation, instilling trust in the virtual asset ecosystem". The SFC has spearheaded efforts to develop a new regulatory approach for VAs (see question 2) but has also expressed caution in several circulars and statements warning investors about the risks of investing in cryptocurrencies and other VAs, and of participating in initial coin offerings ("ICOs") and securities token offerings ("STOs") (see questions 5-10

for further detail).

4. Is there a central bank digital currency ('CBDC') project in your jurisdiction? If so, what is the status of the project?

Since June 2021, the HKMA has been exploring the viability and practicality of introducing e-HKD as a retail CBDC, via Project e-HKD. In May 2023, the HKMA launched the e-HKD Pilot Programme which explores potential uses of e-HKD, Hong Kong's proposed central bank digital currency which leverages the use of blockchain technology for financial transactions. The HKMA has completed Phase I of the programme, studying retail use cases in various areas such as programmable payments, settlement of tokenised assets, and offline payments. Phase 2 has commenced in March 2024, which delves deeper into select pilots from Phase 1 where an e-HKD could add unique value, namely programmability, tokenisation and atomic settlement, as well as explore new use cases that have not been covered in the previous phase.

To support the development of the tokenisation market and e-HKD, the HKMA has in March 2024, announced the commencement of a new wholesale central bank digital currency project – Project Ensemble. It aims to support Phase 2 of the e-HKD Pilot Programme to accelerate the prototyping, development and testing of use cases by pilot participants, as well as facilitate the study of interoperability and interbank settlement between e-HKD and other forms of tokenised money. To facilitate instant cross-border payments and settlements using CBDCs, BIS Hub, the HKMA along with other project participants have been developing a CBDC platform shared among participating central banks and commercial banks, built on DLT – Project mBridge. A platform based on a new blockchain – the mBridge Ledger – was built to support real-time, peer-to-peer, cross-border payments and foreign exchange transactions. In June 2024, the HKMA announced that the project has reached the minimum viable product stage. The platform can now undertake real-value transactions (subject to jurisdictional preparedness) and is also compatible with the Ethereum Virtual Machine.

5. What is the current approach in your jurisdiction to the treatment of cryptoassets and decentralised finance ('DeFi') for the purposes of financial regulation?

Treatment of cryptoassets

Regulators have taken an active interest in and proactive approach to regulating VAs, including cryptoassets in Hong Kong. The HKMA and SFC have also regularly issued warnings about the risks and regulatory requirements relating to VAs (covering topics such as NFTs (see question 8), ICOs (see question 9) and STOs and VA futures). For example, in November 2019, the SFC issued a paper warning investors about the risks associated with VA futures contracts, focusing on the fact that they are largely unregulated, highly leveraged, and subject to extreme price volatility. A March 2019 statement also reminded investors to be wary of the risks associated with offerings structured to have features of traditional securities offerings but involving security tokens, which are digital representations of ownership of assets (e.g., gold, or real estate) or economic rights (e.g., a share of profits or revenue) utilising blockchain technology (please see questions 8-9 for warnings on NFTs and ICOs). The financial regulatory framework in the jurisdiction continues to develop.

Certain VA-related activities may come within the scope of Hong Kong's financial regulation regime by virtue of classification as "securities". The SFC's guidance, published on September 2017, indicates that, under certain circumstances, cryptocurrencies, and other VAs (e.g., those offered via an ICO or STO) may constitute "securities", as defined under the SFO – and thus be subject to Hong Kong securities law. More specifically, where digital tokens: (i) represent equity or ownership interests in a corporation carrying certain rights, these tokens may be "shares"; (ii) are used to create or to acknowledge a debt or liability owed by the issuer, these may be a "debenture"; or (iii) have their proceeds managed collectively by the ICO scheme operator to invest in projects, enabling token holders to participate in a share of the returns, these may be an interest in a collective investment scheme ("CIS").

Where the digital tokens involved in an ICO or STO fall under the definition of "securities", dealing in or advising on, or managing or marketing a fund investing in, such digital tokens may constitute a regulated activity requiring licensing by or registration with the SFC, unless an exemption applies.

As discussed below, even where the VAs concerned do not constitute "securities", a licence is required for certain activities under the new AMLO regime that came into force in June 2023, and certain VA-specific guidelines issued by regulators may be applicable. Licensed intermediaries may also be required to comply with VA-specific licensing conditions imposed by the SFC.

Virtual Asset Trading Platform Operators

Since 2019, an opt-in licensing regime has been administered by the SFC for VATPs offering "security" token trading, requiring operators of VATPs which offer trading service in at least one "security" to hold Type 1 (dealing in securities) and Type 7 (providing automated trading services) regulated activity licences.

On 1 June 2023, a landmark new licensing regime came into effect expanding the scope of regulation to VATPs offering "non-security" token trading and permitting VATPs to offer certain services to retail investors (see question 2).

Under the new framework, a VA is defined as a cryptographically secured digital representation of value that: (i) is expressed as a unit of account or a store of economic value; (ii) either: (a) is used, or intended to be used, as a medium of exchange accepted by the public for payment for goods or services, the discharge of a debt and/or investment; or (b) provides voting rights on the management of the affairs of, or changes to the terms applicable to, any cryptographically secured digital representation of value; (iii) can be transferred, stored or traded electronically; and (iv) satisfies other characteristics prescribed by the SFC. This definition expressly excludes CBDCs, securities or futures contracts and certain other types of tokens.

A VA service is defined as operating a VA exchange i.e. providing services through means of electronic facilities whereby (a) offers to sell or purchase VAs are regularly made or accepted in a way that results in a binding transaction; or (b) persons are regularly introduced to other persons so they may negotiate or conclude sales or purchases of VAs in a way that results in a binding transaction; and (c) where client money or client VAs come into the possession of the person providing the services.

To acquire a VATP licence, an applicant must submit the required application documents (which include an external assessor's report) to the SFC and appoint not less than two Responsible Officers to supervise the conduct of its regulated activities. An applicant for a VATP licence, its Responsible Officers, licensed representatives, directors, and ultimate owners must satisfy the SFC's fit and proper test. These requirements broadly cover a person's financial status or solvency; relevant qualifications and experience; reputation, character, and integrity; and pre-existing disciplinary record.

Virtual Asset Fund Managers

Regulators have also issued guidance concerning VA

fund managers.

The SFC's November 2018 Statement and SFC-HKMA 2023 Circular clarified that the SFC will supervise the following types of VA portfolio managers: (i) firms managing and distributing funds which invest in VAs that do not constitute "securities" or "futures contracts"; and (ii) firms licensed for Type 9 (asset management) regulated activity to manage portfolios, the portfolios of which include VAs that do not constitute "securities" or "futures contracts". Such portfolio managers and fund distributors are subject to SFC oversight, subject to a de minimis threshold of 10% of the gross asset value of the fund being invested in VAs.

Supervised firms must comply with the SFC's Terms and Conditions for licensed corporations or registered institutions which manage portfolios that invest in virtual assets, which were published in revised form in October 2023. The key areas covered by the Terms and Conditions include: (i) codes and guidelines, (ii) financial resources, (iii) custody of fund assets and client money, (iv) operations (which covers risk management control techniques and procedures), (v) dealing with the fund and fund investors and (vi) reporting to the SFC or the HKMA.

As of 30 September 2024, 28 entities were licensed by the SFC to manage portfolios investing more than 10% in VAs.

Other virtual asset related activities

The SFC-HKMA 2023 Circular published in December 2023 provides important further guidance for VA intermediaries:

Distribution of VA-related products: VA-related products are very likely to be considered "complex" products and (except for a limited suite of products) should only be offered to professional investors. Intermediaries should assess whether clients have sufficient knowledge of VAs, and adequate net worth to bear the risks associated with trading VA-related products.

Provision of VA dealing services: intermediaries should partner only with SFC licensed VA trading platforms for the provision of VA dealing services. As trading in non-security VAs may impact an intermediary's general fitness and properness to conduct regulated activities, intermediaries must comply with SFC and HKMA regulatory requirements, irrespective of whether the VAs involved are regulated securities. Additional requirements apply where VA dealing services are provided to retail clients.

Provision of VA advisory services: intermediaries must comply with SFC and HKMA regulatory requirements when providing advisory services, irrespective of the nature of the underlying VAs. Such services should be provided only to intermediaries' existing clients to whom they provide Type 1 (dealing in securities) or Type 4 (advising on securities) regulated services.

The transition period concerning the requirements in the SFC-HKMA 2023 Circular came to an end in January 2024.

Cryptocurrencies as currency?

Hong Kong regulatory authorities have consistently affirmed that cryptocurrencies, such as Bitcoin, are not legal tender and should not be characterised as currency. The October 2022 FSTB Policy Statement states that VAs and cryptocurrencies cannot serve as legal tender in Hong Kong, "as they are not by law regarded as valid and legal means of payment to adequately and effectively fulfil payment obligations".

In a circular to authorized institutions published in March 2019, the HKMA endorsed the Basel Committee on Banking Supervision's statement on crypto-assets and stated that it expects authorized institutions to take note of the prudential expectations regarding banks' exposures to crypto-assets and related services. The HKMA further noted that authorized institutions planning to engage in VA-related activities should first discuss with the HKMA and demonstrate that they have put in place appropriate systems and controls to identify and manage risks, highlighting that crypto-assets do not reliably provide the standard functions of money and are unsafe to rely on as a medium of exchange or a store of value.

Other statements by public bodies such as the Hong Kong Police Force ("HKPF"), Customs and Excise Department and the HKMA confirm their view that VAs and cryptocurrency should be understood as "virtual commodities" rather than currency.

The Hong Kong Government, in collaboration with relevant regulators, has also been exploring options to develop a retail CBDC (see question 4).

Treatment of DeFi

There is currently no specific regulatory framework for DeFi in Hong Kong. However, as the SFC explained in a keynote speech in April 2023, the approach will be the same as those applicable to a traditional finance activity, under the "same business, same risk, same rule" principle. This means that for example, if a decentralised

platform allowed trading in VA which constitutes securities or futures as defined under the SFO, then the platform and its operators may be required to be licenced. Likewise, offer of collective investment schemes to the public in Hong Kong via DeFi liquidity pooling protocol which falls under the definition of CIS may also be subject to regulations.

The June 2024 report released by Hong Kong Institute for Monetary and Financial Research, the research arm of the Hong Kong Academy of Finance titled "Decentralised Finance: Current Landscape and Regulatory Developments" also suggested several areas of research which will inform a well-defined and comprehensive regulatory framework in regards DeFi. They include: (i) increasing accountability of entities and actors operating DeFi protocols by introducing or amending legal frameworks to recognise and define such entities; (ii) ensuring enforceability of smart contracts by developing safeguards for the automated nature of DeFi protocols; (iii) enhancing global coordination to address regulatory arbitrage and data gaps in the DeFi markets; and (iv) increasing financial stability by ascertaining the interconnections between centralised intermediaries and DeFi entities. As such, there remains to be seen how regulations will expand and adapt to mitigate emerging risks posed by DeFi.

6. What is the current approach in your jurisdiction to the treatment of cryptoassets and DeFi for the purposes of anti-money laundering and sanctions?

Hong Kong public bodies have been warning the public about the risks posed by VAs and cryptoassets since 2014. Having long recognised the heightened AML and CTF risks posed cryptoassets and other VAs, in November 2020 the FSTB published a consultation paper on legislative proposals to enhance AML and CTF regulation in Hong Kong through the introduction of, amongst other measures, a new licensing regime for VATPs. The gazetted amendments to the AMLO came into effect on 1 June 2023.

Further details of the licensing regime now in force can be found at question 2. Licensed VATPs will be subject to the AML and CTF requirements of the AMLO, including customer and counterparty due diligence, ongoing transaction monitoring and record-keeping requirements set out in Schedule 2. Licensees must also comply with the "Travel Rule", which requires VATPs to gather, and make available to counterparties, certain key information to facilitate sanctions screening and transaction

monitoring. In the case of misconduct by a regulated person in relation to such matters, the SFC may impose a fine up to the greater of a maximum of HKD 10 million, or three times the profit gained or loss avoided.

The 2022 Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report published by the Hong Kong Government warned that, as a new segment of the banking sector, virtual banks are at greater risk of their vulnerabilities being tested by cybercriminals and of being used to launder crime proceeds. The report noted, however, that virtual banks have been responsive in addressing these emerging threats.

On the other hand, position regarding the AML and CTF regulation of DeFi is currently not clear, owing to the fact that there is an absence of financial intermediaries in DeFi who are usually responsible for enforcing the required controls.

7. What is the current approach in your jurisdiction to the treatment of cryptoassets and DeFi for the purposes of taxation?

In March 2020, the Hong Kong Inland Revenue Department ("IRD") published a revised version of Departmental Interpretation and Practice Note No. 39, which included a new section on digital assets. The Practice Note clarifies that the profits tax treatment of digital assets will depend on their nature and use. While there is currently no tax guidance specifically applicable for DeFi, cryptocurrency transactions which are conducted through DeFi channels would also be caught by the provisions under the Practice Note.

ICOs: The IRD will review an ICO's white paper and other underlying documents to identify the rights and benefits (e.g., equity interests or a right to access to a future service similar to a voucher) attached to the digital tokens. The tax treatment of the proceeds from an ICO will generally follow from these attributes (and not the form) of the tokens issued.

Digital assets held for investment: If digital assets are bought for long-term investment purposes (i.e., as capital assets), any profits upon disposal of such assets are exempt from profits tax. Whether the digital assets are treated as capital assets or trading stock depends on the specific facts and circumstances.

Cryptocurrency: Hong Kong-sourced profits from cryptocurrency business activities are chargeable to profits tax. Whether the buying and selling, exchange or mining of cryptocurrency amounts to the carrying on of a

trade or business is a matter of fact and degree to be determined upon consideration of all the circumstances (e.g., the degree and frequency of the activity, its purpose, and its level of organisation).

8. Are there any prohibitions on the use or trading of cryptoassets in your jurisdiction? If permitted, is cryptoasset trading common?

Trading of cryptoassets in Hong Kong

Although the use or trading of cryptoassets is not prohibited in Hong Kong, the HKPF and the Customs and Excise Department, and Hong Kong regulators such as the HKMA and the SFC, have published statements and circulars warning investors of the risks associated with investing in or trading in cryptocurrencies and VAs (see question 5). Regulators have also emphasised repeatedly that engaging in regulated activities without being properly licensed or complying with relevant laws and regulations is prohibited.

The amended AMLO imposes a new mandatory licensing regime, which prohibits a person, whether in Hong Kong or elsewhere, from actively marketing regulated VA activities or associated services to the Hong Kong public, unless that person is properly licensed and regulated by the SFC (as mentioned at question 2).

In September 2023, the SFC issued statements regarding an unregulated VATP known as "JPEX" ("JPEX", and the "JPEX Statements", respectively), reminding the public that fraudulent behaviour in connection with VAs can constitute an offence (see question 13 for further detail).

In August 2023 and June 2024, the SFC issued warning statements noting that certain unlicensed VATPs had misleadingly claimed to have submitted licence applications to the SFC despite having not done so or in relation to activities that would not be permitted under the new licensing regime. The SFC reminded VATPs that conducting unlicensed activities in Hong Kong constitutes a criminal offence. The SFC has also on other occasions, issued warning statements of entities suspected of engaging in fraudulent activities purported to be related to virtual assets. Warning statements have also been issued regarding unlicensed entities appearing to offer trading services in crypto-related products.

The SFC's statements on ICOs published in September 2017 and February 2018 warned market participants that, depending on the facts and circumstances of an ICO, digital tokens being offered or sold may constitute "securities" under the SFO, and therefore subject to

securities laws. Offering or selling such securities without complying with relevant securities laws is prohibited. The SFC disclosed in those statements that it had sent letters to seven cryptocurrency exchanges warning them that they must not trade cryptocurrencies constituting "securities" without a licence.

By way of example, in March 2018, the SFC announced that ICO issuer Black Cell had halted its ICO to the Hong Kong public and agreed to unwind ICO transactions for Hong Kong investors, following regulatory action by the SFC over concerns that Black Cell had potentially engaged in unauthorized promotional activities and unlicensed regulated activities. To address the SFC's regulatory concerns, Black Cell agreed not to devise, set up or market any scheme that would constitute a CIS unless in compliance with the relevant requirements under the SFO.

A further statement by the SFC in June 2022 confirmed that similar considerations applied to NFTs which, if they cross the boundary between collectibles and financial assets, may constitute "securities" or a CIS under the SFO.

In December 2022, the SFC published a warning statement regarding virtual asset platforms offering VA "deposits", "savings", "earnings" or "staking" services, noting that whilst such platforms may claim to offer a high interest rate or a daily generation of additional VA at a guaranteed or fixed rate, a vast majority of these platforms is unregulated, and these platforms carry significant risks. The SFC reminded those offering such services that where these in fact constitute a CIS, it is an offence for such a person to market or distribute interests in a CIS without an appropriate SFC licence.

Rise of cryptoasset trading in Hong Kong

A joint report published in January 2020 by PricewaterhouseCoopers ("PwC") and Crypto Valley (see question 9) ranked Hong Kong as one of the leading token-offering jurisdictions worldwide throughout 2018 and 2019 in terms of funding volume and number of completed offerings. The June 2021 report by the International Monetary Fund ("2021 IMF Report") found that in a 2019 ranking of jurisdictions by cryptocurrency exchanges, Hong Kong was identified as the fourth largest, with 22 exchanges, ahead of Singapore.

According to a June 2022 report by Chainalysis, as of June 2022, annual transaction volume in Hong Kong had grown 9.5% year-on-year (from VAs received by Hong Kong market participants with a value of nearly USD60 billion to over USD 65 billion). Most transactions in East

Asia were of an amount equivalent to at least USD 1 million, with "retail" transactions (i.e., equal to or lesser than the equivalent of USD 10,000) making up less than 10% of transaction volume. Nonetheless, with the recent shift towards clearer regulations for retail investors trading digital assets in Hong Kong following the coming into force of the new VATP regime (see questions 2 and 5-6), local retail demand for cryptoasset trading may rise.

Financial institutions in Hong Kong are increasingly exploring opportunities relating to VAs and tokens. In February 2023, a private blockchain platform developed by Goldman Sachs was used for the offer of a tokenised green bond by the Hong Kong Government (see question 3). In June 2023, Bank of China's Hong Kong-based global investment arm announced its issuance of CNH 200 million of fully digital structured notes tokenised on the Ethereum blockchain, the first occasion that a Chinese financial institution has issued a tokenised security in Hong Kong.

In July 2022, OSL announced that it was the first Type 1 (dealing in securities) licensed digital asset broker to distribute security tokens to professional investors in Hong Kong via a private STO. Each token represented a USD 10,000 unit of a Bitcoin-linked, coupon-rate USD bond. The tokens were developed using the Ethereum blockchain and carried a fixed and a bonus coupon linked to Bitcoin's performance.

Following a statement published by the SFC in October 2022, setting out regulatory requirements and expectations for VA exchange traded funds ("ETFs") that obtain exposure to VAs primarily through futures contracts, two such ETFs were listed on the HKEX in December 2022, which became the first Asian exchange to offer such products. The ETFs track standardised, cash-settled Bitcoin futures contracts and Ether futures contracts traded on the Chicago Mercantile Exchange. Following the success of the two VA futures ETFs, the HKEX has also welcomed the listing of Asia's first spot VA ETFs in April 2024. In the first quarter of 2024, the combined average daily turnover for Hong Kong's listed VA Futures ETFs reached HKD 51.3 million, up from HKD 8.9 million a year earlier. Additionally, the VA futures ETFs attracted HKD 529 million in net inflows during the first quarter of 2024, demonstrating a strong interest in virtual asset trading in Hong Kong.

9. To what extent have initial coin offerings ('ICOs') taken place in your jurisdiction and what has been the attitude of relevant authorities to

ICOs? If permissible, what are the key requirements that an entity would need to comply with when launching an ICO?

Hong Kong had previously emerged as a leading Asian ICO hub, due to, amongst other factors, the PBoC's announcement in September 2017 of an outright ban on ICOs in China.

According to a joint report published in January 2020 by PwC and Crypto Valley, Hong Kong was one of the leading token-offering jurisdictions worldwide throughout 2018 and 2019 in terms of funding volume and number of completed offerings. The report also ranked Hong Kong as the leading jurisdiction for token offerings globally in 2019 by total funds raised, with a total of USD 1,009 million raised through four closed offerings (accounted for primarily by the USD 1,000 million raised by cryptocurrency exchange Bitfinex in May 2019).

In addition to Bitfinex, other notable examples of successful Hong Kong ICOs include: (i) Gatcoin, which offered a solution for businesses to transform their traditional discount coupons and loyalty points into digital tokens and raised USD 14.5 million in January 2018; (ii) AirSwap, which planned to develop a decentralized cryptocurrency exchange platform ("DEX") and raised USD 36 million in October 2017; and (iii) the OAX Foundation, which planned to build a DEX and raised USD 18 million in July 2017.

However, ICO activity has declined significantly since its peak in 2018 as an active form of VA fundraising, consistent with the global decline in VA fundraising and increasing regulatory scrutiny. Such increased regulatory scrutiny includes, for example, a statement issued by the SFC on September 2017 on ICOs that such offerings may expose investors to heightened risks of fraud as well as the risks of insufficient liquidity, or volatile and opaque pricing.

Given the decline in ICO activity, as noted in the 2021 IMF Report, the SFC does not currently consider ICOs to be a significant source of risk to investors.

For regulations applicable to the launch of ICOs, please refer to responses in question 5. Where the digital tokens involved in an ICO fall under the definition of "securities", dealing in or advising on, or managing or marketing a fund investing in, such digital tokens may constitute a regulated activity requiring licensing by or registration with the SFC, unless an exemption applies.

10. Are there any legal or regulatory issues concerning the transfer of title to or the granting of security over cryptoassets?

The extent to which legally effective transfers of title to, or granting of security over, legal tokens and VAs can be achieved will depend primarily on whether such tokens and VAs constitute "property" under Hong Kong law.

Recently, the Court of First Instance clarified in *Re Gatecoin Limited (in liquidation)* [2023] HKCFI 91 that cryptocurrencies fulfil the necessary criteria to be considered "property" and are capable of being held on trust. The Court applied the four criteria for "property" set out in *National Provincial Bank v Ainsworth* [1965] AC 1175 to cryptocurrency, concluding that cryptocurrency satisfied the requirements of being: (i) definable; (ii) identifiable by third parties; (iii) capable of assumption by third parties; and (iv) having some degree of permanence or stability.

Several other first instance judgments handed down since 2020 have already treated cryptocurrencies as property for the purposes of proprietary injunctive relief (see: *Nico Constantijn Antonius Samara v Stive Jean-Paul Dan* [2021] HKCFI 1078; *Yan Yu Ying v Leung Wing Hei* [2021] HKCFI 3160; and *Huobi Asia Ltd & Anor v Chen Boliang & Anor* [2020] HKCFI 2750).

Whilst the reported cases dealing with VAs in Hong Kong were concerned with their treatment in the context of insolvency or injunctive relief rather than issues of conveyancing or security, our view is that on the basis of VAs constituting property under Hong Kong law, it should be possible (subject to the terms of such assets) to transfer legal title to, and to grant security over, VAs in the same way as other intangible property.

In the FSTB Policy Statement, the Hong Kong Government acknowledged that the unique characteristics of VAs "may not fit squarely into the current private property law categories or definitions in Hong Kong" and noted that it was open to future review of property rights regarding tokenised assets.

11. How are smart contracts characterised within your legal framework? Are there any enforceability issues specific to the operation of smart contracts which do not arise in the case of traditional legal contracts?

The HKMA's Second DLT Whitepaper, reflecting input from the Technology Committee of The Law Society of

Hong Kong, defines a smart contract as an arrangement whereby autonomous software running on a DLT platform automatically exchanges assets that are stored or represented on the DLT platform.

Whether a smart contract can be considered a legal contract is still a point of open discussion. The Second DLT Whitepaper notes that smart contracts should not be understood simply as contractual documents in digital form. While a smart contract usually contains the mechanics for execution, performance, and enforcement, it may not contain the entirety of the terms forming a contract at law. Using a smart contract without explicit contractual terms to completely replace a legal contract could cause uncertainty for participants in the event of unforeseen consequences or disputes.

There may, however, be other ways to characterise a smart contract and its relationship with relevant stakeholders that do give rise to legal recourse. Legal rights and remedies could arise from a separate legally binding contract, such as for securities trading on an exchange or Decentralised Autonomous Organisation ("DAO"), or other grounds, such as negligence, unjust enrichment and/or breach of fiduciary duties. Remedies founded in unjust enrichment may be available to effect the restitution of unjust gains resulting from a breach of a smart contract.

The Second DLT Whitepaper also points to the 2016 DAO Ethereum hack as a reminder that programming / modelling errors and other such issues introduce the risk that smart contracts will fail to reflect the intention of their creators. Steps must therefore be taken to ensure that, if an undesirable consequence should occur, there is already a pre-agreed governance structure and contractual framework in place to handle the situation. Furthermore, the smart contract should contain an "escape hatch" or clean path for modifying and undoing the smart contract in light of unforeseen eventualities, which would allow human intervention under strict conditions (e.g., all party approval) without realistically threatening the immutability of the smart contract.

Given the underlying risks, the Law Society of Hong Kong has recommended that smart contracts should be adopted only if their design follows the latest best practices and international standards, such as the "escape hatches" referred to above, and that parties should use them only having evaluated the accompanying risks.

12. How are Decentralised Autonomous

Organisations ('DAOs') treated in your jurisdiction?

The treatment of DAOs is still under consideration by Hong Kong courts and regulators. However, a landmark decision *Mantra DAO Inc. and Another v. John Patrick Mullin and Others* [2024] HKCFI 2099 has recently been issued addressing DAO operators' duties to maintain proper accounts. The substantive hearing and decision regarding the DAO's ownership, management and control is still pending.

The case concerned a DAO governed as follows: decision making over assets of the DAO lie ultimately with the holders of digital tokens ("OM Tokens"). As a DAO lacks legal personality, legal entities are set up specifically for holding assets for the benefit of OM Token holders, which are in turn governed by members of its council ("Councillors"). Councillors are elected by OM Token holders periodically.

The courts found that the Councillors had a duty to keep proper accounts of the DAO's business operations. The court issued interim relief against the Councillors, mandating disclosure of the DAO's financial records to the Plaintiffs who initially conceived and set up the DAO project. The decision serves as a reminder for those operating DAOs about their obligations to maintain proper accounts, that they also owe disclosure obligations to relevant stakeholders.

13. Have there been any governmental or regulatory enforcement actions concerning blockchain in your jurisdiction?

The SFC has been active in taking enforcement action against cryptocurrency exchanges and issuers.

Most recently, in September 2023, the SFC issued the JPEX Statements, warning the public regarding JPEX and clarifying that no entity in the JPEX group is licensed by the SFC or has applied to the SFC for a licence to operate a VATP in Hong Kong, as well as flagging a number of suspicious features about the practices of JPEX and those actively promoting JPEX to the Hong Kong public. The SFC subsequently revealed that JPEX is suspected of fraud and that this matter has been referred by the SFC to the police. As mentioned in question 2 above, on 29 September 2023, following the publication of the JPEX Statements and as part of SFC's efforts to disseminate information on VATPs in a clear, transparent and timely manner, the SFC published several lists of VATPs on its website.

In August 2023 and June 2024, the SFC issued warning statements in relation to (a) misleading claims by certain unlicensed VATPs that they have submitted licence applications to the SFC despite not having done so, (b) activities that would not be permitted under the new licensing regime and (c) suspected fraudulent VA related activities (see question 8).

In July 2021, the SFC published a statement warning that it was aware that Binance had offered trading services in stock tokens in several jurisdictions and that it was concerned such services may also be offered to Hong Kong investors. The SFC emphasised that no entity in the Binance group was licensed or registered to conduct a regulated activity in Hong Kong and that it "[would] not hesitate to take enforcement action against unlicensed platform operators where appropriate".

As described in question 8, in March 2018 the SFC confirmed that ICO issuer Black Cell had halted its ICO to the Hong Kong public and agreed to unwind ICO transactions for Hong Kong investors, following regulatory action by the SFC over concerns that Black Cell had potentially engaged in unauthorized promotional activities and unlicensed regulated activities. As discussed at question 8, the SFC had previously noted it had written to seven cryptocurrency exchanges warning them that they must not trade cryptocurrencies constituting "securities" without a licence.

Other authorities have also taken action on VA-related offences. In February 2019, the HKPF arrested Wong Ching-Kit, better known as "Coin Young Master", and his colleague for (among other offences) conspiracy to defraud investors through so-called cryptocurrency "mining machines" sold by the pair relating to the cryptocurrency Filecoin. In July 2021, the Customs and Excise Department investigated its first case of a suspected money laundering syndicate involving virtual currencies.

In 2023, financial losses from VA-related scams had risen to HKD 4.4 billion, as compared to HKD 1.7 billion in 2022, with the number of cases increasing by 46% compared to 2022 figures. The 2022 Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report noted that the HKPF is committed to combating VA-related crime, and that a taskforce has been formed to monitor the latest industry developments and crime trends.

14. Are there any other generally-applicable laws, case law or regulations that may present issues for the use of blockchain technology (such as

privacy and data protection law or insolvency law)?

The HKMA's Second DLT Whitepaper, published in October 2017, identified seven broad legal issues arising from the use of DLT, namely: (i) legal basis (validity and enforceability); (ii) data protection and privacy (accessibility, immutability and cross-border considerations); (iii) cross-border and localisation issues (cross-border data flow, legal enforceability and localisation law); (iv) smart contracts (legal basis and effects); (v) liability (governance models and liability of participants); (vi) competition / antitrust laws (fair competition and antitrust practice); and (vii) legal issues in specific applications (asset management, mortgages / e-conveyancing, trade finance and digital ID management).

On privacy and data protection, the Second DLT Whitepaper explained that the three key characteristics of DLT that need addressing under the Personal Data (Privacy) Ordinance (Cap. 486) are: (i) the accessibility of certain DLT platforms, in which all nodes have equal access to all stored personal data regardless of whether they need to see it; (ii) the immutability of stored data, whereby data cannot be amended or erased; and (iii) the often cross-border nature of DLT, meaning that personal data may be stored outside Hong Kong. The Second DLT Whitepaper concluded that the simplest way to address privacy concerns appears to be to avoid storing personal data in the ledger, and rather keep only the hashes of personal data there. Storing personal data off-ledger in more conventional databases while keeping hashes in the ledger would ensure data integrity while controlling and limiting access to personal data. It is unclear, however,

which steps are being taken to address such concerns.

The use of blockchain technology, in particular cryptocurrencies and other VAs, also raises obvious AML and CTF concerns given the unregulated nature of many parts of the industry. As noted by the HKMA's then-Chief Executive in a speech given on September 2018, as many crypto-assets are designed such that anonymous email accounts can be used for trading and transfers without a central clearing agent, they effectively bypass the existing regime to combat money laundering and terrorist financing. Banks and other regulated financial institutions have, therefore, found it difficult to comply with statutory or supervisory know your customer (KYC) requirements. As discussed at questions 2 and 6, the AMLO was amended partly in response to such concerns.

Cryptocurrencies and other VAs also present potential problems in the context of insolvency law, in particular with respect to asset tracing and the appropriate legal treatment of cryptocurrencies (see question 10).

15. Are there any other key issues concerning blockchain technology in your jurisdiction that legal practitioners should be aware of?

The regulatory environment concerning VAs is consistently developing in Hong Kong, with the most recent significant development being the new licensing regime for VATPs applied in Hong Kong since 1 June 2023 (as discussed at questions 2 and 5) as well as the proposed licensing regime for stablecoin issuers and the proposed VA OTC Regime discussed in question 2. Legal practitioners would be advised to follow the most recent developments.

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