The Legal 500
Country Comparative Guides

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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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? What are the key applications of these technologies in your jurisdiction?

Hong Kong has embraced blockchain and distributed ledger technology ("DLT"), reflected in the breadth of industry sectors across which its practical uses can be seen. The 2019 Blockchain Summit Hong Kong covered 18 industry sectors, namely: banking and finance; supply chain and logistics; insurance; energy; healthcare and pharmaceuticals; government; transport; telecoms; HR; marketing and advertising; retail; entertainment and content; property and construction; regulation and policy; charity; legal; investor and ICO; and developer. The Hong Kong Blockchain Week 2020 saw the global blockchain community converge in a virtual setting to discuss the latest developments and insights into the evolving, real-world applications of blockchain technology in finance, investment, enterprise, socially important projects and global payment industry.

Fintech and Insurtech have been particular areas of focus for the Hong Kong Government and the key Hong Kong financial regulators, the Hong Kong Monetary Authority ("HKMA"), the Securities and Futures Commission ("SFC") and the Insurance Authority ("IA"), reflecting Hong Kong's long-held position as one of the world's leading international financial centres.

According to a 1 June 2020 report (the "2020 FSTB Report") by the Financial Services and the Treasury Bureau of the Hong Kong Government ("FSTB"), in 2019 blockchain firms accounted for 39% of the new Fintech firms brought in to Hong Kong by Invest HK, the Hong Kong Government department responsible for foreign direct investment. This was up from 27% the previous year, representing the biggest growth of any Fintech sub-sector. 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.

2. To what extent are tokens and virtual assets in use in your jurisdiction? Please mention any notable success stories or failures of applications of these technologies.

Virtual assets and tokens are a growth area. The FSTB Report (as noted in the response to question 1 above) states that of the new blockchain firms brought in to Hong Kong by Invest HK in 2019, 27% were trading platforms for digital assets, 14% were involved in custody of digital assets and 5% in security tokens.

As described in the response to question 10 below, 2020 saw the first SFC licensing and approval of an advisor and distributor of a Hong Kong cryptocurrency fund. On 16 December 2020, the SFC announced it had granted its first licence to a virtual asset trading platform in Hong Kong, subject to it only serving professional investors under the close supervision of the SFC and being subject to tailor-made requirements similar to those which apply to securities brokers and automated trading venues.

As described in the response to question 12 below, Hong Kong has emerged as a leading Asian (and indeed global) hub for initial coin offerings ("ICOs") in recent years. An example of a successful practical application of token / virtual asset technology was the launch in March 2019 by Hong Kong’s sole physical gold and silver exchange, the Chinese Gold & Silver Exchange (CGSE), of a new digital gold certificate trading platform, GoldZip, backed by physical gold reserves. The platform is powered by blockchain technology and allows investors to trade in amounts smaller than the current minimum trade on the exchange.

Whilst there have been no widely publicised major failures of the application of token / virtual asset technology in Hong Kong, the SFC has issued a number
of statements and circulars concerning cryptocurrencies and other virtual assets, one of the focuses of which has been to warn investors of the risks inherent in investing in such assets and of participating in ICOs and securities token offerings ("STOs"). These are discussed in further detail in the responses to questions 10-16 below.

Interest in non-fungible tokens have also grown in Hong Kong especially in the field of art and collectibles. 2021 saw the first non-fungible token art shows being held in the city. A local football club, Resources Capital FC, released a series of limited-edition collectibles through non-fungible tokens, becoming the first Asian football club to do so. Local celebrities and film director have also launched non-fungible tokens projects including the sale of non-fungible tokens based on behind-the-scenes footage and new music videos. A local digital asset exchange also has plans to launch a non-fungible token platform in Hong Kong.

3. To what extent has blockchain technology intersected with ESG (Environment, Social and Governance) outcomes or objectives in your jurisdiction?

Utilising blockchain technology’s unique features in providing a secure platform for data entry and record, certain companies have offered blockchain-enabled technology systems to support ESG reporting requirements. For example, Diginex - a software as a service (SaaS) provider - has launched the DiginexESG platform, which is able to support its users with their compliance requirements under The Stock Exchange of Hong Kong Limited’s (HKEX) ESG Reporting Guidelines. HKEX listed companies could make use of the DiginexESG software to streamline their ESG data reporting process while simultaneously confirming compliance with the latest HKEX ESG guidelines.

Cyberport, the digital technology business park backed by the Hong Kong government, has a number of community members firms that use blockchain technology to develop diversified solutions in the financial and non-financial industries. Cyberport has also launched the Cyberport Incubation Programme to support entrepreneurs and start-ups by offering a range of business and professional services and HK$500,000 in support over 24 months. One of the incubates, Block Aero, has built a blockchain platform aimed at airlines and aircraft maintenance companies. The blockchain of assets contains records of maintenance and repair work and supply chain information with the aim of facilitating information consolidation, documentation and verification to increase efficiency and lower operating costs. Another incubatee, Block Dynamics, built a sourcing platform for a French waste management company based on blockchain technology that allows material suppliers to submit quotations in real-time during sealed-bid auctions to assist the company in lowering its supply costs. Block Dynamics is also developing a blockchain platform to assist corporates and individuals in monitoring their carbon footprint.

Blockchain technology can also be deployed for funding allocation and to lower administrative costs. Another Cyberport incubatee, Shanzhai City, provides a blockchain platform to social welfare organisations to record information on funding, grants and internal administrative costs such that government grants and charitable donations can be better allocated.

The HKMA and the Bank for International Settlements (BIS) Innovation Hub Hong Kong Centre also announced on 24 August 2021 that they are joining forces with the technology industry to build a prototype digital infrastructure that enables green investments, improves transparency on the use of proceeds, and thereby helps meet regional and global environmental and sustainability goals. This project, named Project Genesis, will explore the tokenisation of green bonds enabling investment in small denominations, combined with real-time tracking of environmental outputs. The HKMA welcomed the collaboration with BIS Innovation Hub on the novel experimentation on the symbiosis of sustainability and tech with the goal that technologies such as blockchain and smart contracts, combined with the internet-of-things, could streamline the bond issuance process, improve efficiency in distribution and facilitate reporting on the use and environmental impact of green bonds proceeds, thus enhancing transparency to green bond investors.

4. Has COVID-19 provoked any novel applications of blockchain technologies in your jurisdiction?

Although we are not aware of any novel applications of blockchain technologies in response to COVID-19, the 2020 FSTB Report notes that the outbreak of the pandemic has accelerated incumbent financial institutions to embrace Fintech and provides a window of opportunity for the Hong Kong Government to promote wider fintech adoption, for example through the recently introduced Faster Payments System ("FPS") (a real-time gross settlement payment system that connects traditional banks and electronic payment and digital wallet operators in Hong Kong, and operates on a 24/7 basis), e-wallets, virtual banks and insurers.

On 28 September 2020, the Chief Executive of the HKMA
similarly noted in his opening keynote speech at the Hong Kong Institute of Bankers (HKIB) Annual Banking Conference that the COVID-19 pandemic has given new impetus to the use of mobile banking and electronic payment services, which he referred to as “the most important technology in times of social distancing”. He noted that around 80% of payments under the Cash Payout Scheme had been made through electronic registration, easily beating the HKMA’s expectations; and that the FPS, introduced just over two years prior to the date of the speech, had nearly six million registrations and handled about 400,000 transactions per day as at the date of the speech – over twice the amount compared with the previous year.

5. 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?

There is no blockchain-specific legislation or regulatory frameworks in Hong Kong. However, blockchain and DLT technology invariably engage existing legal and regulatory regimes to some extent, depending on the particular technology in question.

In the Fintech space, on 25 October 2017 the HKMA published the ‘Whitepaper 2.0 on Distributed Ledger Technology’ (the “Second DLT Whitepaper”). This identified 7 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 model and liability of participants); (vi) competition / anti-trust laws (fair competition and anti-trust practice); and (vii) legal issues in specific applications (asset management, mortgages / e-conveyancing, trade finance and digital ID management).

On 27 March 2019, the HKMA granted the first 3 virtual banking licences for Hong Kong (and has subsequently issued a number of further virtual bank licences). From a legal/regulatory perspective virtual banks are subject to the same set of supervisory requirements applicable to conventional banks (albeit that some of these supervisory requirements are adapted to suit the business models of virtual banks under a risk-based and technology-neutral approach).

On 20 December 2018, the IA granted the first virtual insurance company licence under its Fast Track pilot scheme for applications for authorizations of new insurers owning and operating solely digital distribution channels (and has subsequently issued a number of further virtual insurance company licences). However, like 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 a number of statements and circulars concerning cryptocurrencies and other virtual assets (see the responses to questions 10-16 below for further detail). These include the statement and circular issued on 1 November 2018, setting out a new regulatory approach for virtual assets. The new measures aim to regulate the management and distribution of virtual asset funds so that investors’ interests are protected at either the fund management level or distribution level or both. The measures do not, however, amend the law or the definitions of “securities” or “futures contracts”. Instead they clarify existing requirements and impose new requirements primarily in the form of licensing conditions on intermediaries. The statement also set out details of a conceptual framework to explore the regulation of virtual asset trading platform operators, which was followed by the publication on 6 November 2019 of a position paper setting out a new regulatory framework for virtual asset trading platforms.

From 3 November 2020 to 31 January 2021, the FSTB conducted a publication on legislative proposals to enhance anti-money laundering (“AML”) and counter-terrorist financing (“CTF”) through the introduction of a licensing regime for virtual asset service providers (see the response to question 10 below for further detail).

6. 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 the key Hong Kong regulators have each launched various initiatives aimed at promoting the use of blockchain and DLT (see the response to question 6 below). Equally, the Government and the key regulators have each expressed caution as to the risks that come with such technology.

This balanced approach is reflected in the HKMA’s Second DLT Whitepaper (described in the response to question 5 above and the response to question 8 below),
which on the one hand stresses the importance and value of DLT technology, whilst on the other hand emphasising the attendant operational and legal / regulatory risks.

Similarly, whilst the SFC has developed a new regulatory approach for virtual assets (referred to in the response to question 6 above), it has also expressed caution in a number of circulars and statements warning investors about the risks of investing in cryptocurrencies and other virtual assets and of participating in ICOs and STOs (see the responses to questions 10-16 below for further detail).

Please refer to the response to question 3 above for further detail in relation to Project Genesis, a collaborative project between the HKMA, the BIS Innovation Hub Hong Kong Centre and companies in the technology industry.

7. Are there any governmental or regulatory initiatives designed to facilitate or encourage the development and use of blockchain technology (for example, a regulatory sandbox)?

The Fintech Facilitation Office (FFO), established by the HKMA in 2016, facilitates the development of the Fintech ecosystem in Hong Kong and promotes Hong Kong as a Fintech hub in Asia. In September 2017, the HKMA announced seven initiatives to prepare Hong Kong to move into a “new era of smart banking”, namely: (i) the Faster Payments System (supporting the use of mobile phone numbers or email addresses for payments in Hong Kong dollar and Renminbi anytime and anywhere); (ii) an enhanced Fintech Supervisory Sandbox (originally launched in September 2016); (iii) the promotion of virtual banking; (iv) the ‘banking made easy’ initiative (through a new taskforce set up to work with the banking industry); (v) open application programming interface (API) for the banking industry (a computer programming approach for facilitating exchange of information and executing instructions between different computer systems); (vi) cross-border collaboration with regulators in other jurisdictions; and (vii) enhanced collaboration with the Hong Kong Applied Science and Technology Research Institute, Science Park and Cyberport to promote the introduction of new technology and processes.

The SFC has established a Fintech Advisory Group in order to: (i) obtain information on the latest trends of Fintech; (ii) collect stakeholders’ input on specific Fintech themes; (iii) identify the opportunities, risks and regulatory perimeter implications of Fintech; and (iv) broaden the understanding of Fintech as an evolution of the financial services industry. The SFC has also established the SFC Regulatory Sandbox to provide a confined regulatory environment for qualified firms to operate regulated activities under the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (the “SFO”) before Fintech is used on a fuller scale. The SFC has also entered into a number of Fintech cooperation agreements with its counterparts in other jurisdictions.

The IA has launched various initiatives to promote Insurtech development in Hong Kong, including: (i) the Insurtech Sandbox; (ii) a fast track for applications for authorization of new insurers owning and operating solely digital distribution channels; (iii) the Insurtech Facilitation Team (to enhance the communication with business involved in the development and application of Insurtech in Hong Kong, as well as to promote Hong Kong as an Insurtech hub in Asia); (iv) the Working Group on Embracing Fintech in Hong Kong under the Future Task Force (focusing on promoting the application of Fintech in the insurance industry); and (v) the entry into cross-border cooperation agreements with regulators in other jurisdictions.

The HKMA, the SFC and the IA are members of the Global Financial Innovation Network, to which firms can apply to conduct cross-border tests of innovative financial products or services.

The HKMA and the BIS Innovation Hub Hong Kong Centre have joined forces with the technology industry under Project Genesis to explore the tokenisation of green bonds enabling investment in small denominations, combined with real-time tracking of environmental outputs. The project will experiment on the symbiosis of sustainability and tech with the goal that technologies such as blockchain and smart contracts, combined with the internet-of-things, in streamlining the bond issuance process, improving efficiency in distribution and facilitate reporting on the use and environmental impact of green bonds proceeds, thus enhancing transparency to green bond investors (see the response to question 3 above for further detail).

In June 2021, the HKMA commenced Project e-HKD, a retail or general-purpose CBDC (rCBDC) project that aims to study the feasibility of e-HKD. The project comprises of two components: (i) a technology experimentation study and (ii) a comprehensive study of other issues, including legal and policy considerations. On 4 October 2021, the HKMA released a technical whitepaper on retail central bank digital currency (CBDC), titled “e-HKD: A technical perspective” (the “White Paper”) as of part of the technology.
experimentation study under Project e-HKD. The White Paper explores potential architectures and design options that could be applied to the construction of the infrastructure for distributing e-HKD, and reports the initial thoughts and findings. The proposed architecture consists of two layers: (i) a wholesale system for the central bank to issue and redeem CBDC, and (ii) a retail system for commercial banks to distribute and circulate either rCBDC or CBDC-backed e-money. Based on an initial, preliminary analysis of the proposed architecture, the HKMA has identified a number of areas for further discussion and invites comments from academia and the industry on the proposed architecture by making reference to the seven problem statements listed in the White Paper. The deadline for submission of feedback to the White Paper is 31 December 2021. There is no public list of entities that are subject to Hong Kong’s regulatory sandboxes.

8. Have there been any recent governmental or regulatory reviews or consultations concerning blockchain technology in your jurisdiction and, if so, what are the key takeaways from these?

The HKMA commissioned ASTRI to conduct an in-depth and open-minded research project on the deployment of DLT. ASTRI delivered the first stage of the results of the project on 11 November 2016 with the publication of the first ‘Whitepaper on Distributed Ledger Technology’ (the "First DLT Whitepaper"). The First DLT Whitepaper introduced the technology in detail and described three PoC projects on which the HKMA had worked with ASTRI and five leading banks, namely Bank of China (Hong Kong) Limited, The Bank of East Asia Limited, Hang Seng Bank Limited, the Hongkong and Shanghai Banking Corporation Limited, and Standard Chartered Bank (Hong Kong) Limited, and their progress. It further reflected on a number of issues relating to governance, risk management, compliance, security and privacy, and legal matters that were identified during the PoC projects.

The Second DLT Whitepaper, published on 25 October 2017, provided an update and overview of the development of DLT and outlined lessons taken from the three PoC projects. It also suggested some key principles relating to issues of governance, control measures and security management for DLT, and described common legal and compliance issues encountered when deploying DLT, along with some possible steps to address these issues. The HKMA received professional input from Deloitte and PwC in relation to issues of governance, control measures and security management in the deployment of DLT, as well as professional contributions from The Law Society of Hong Kong and academic input from law professors Dirk Zetzsche, Ross Buckley and Douglas Arner dealing with the privacy and legal issues identified.

The HKMA noted in its concluding remarks in the Second DLT Whitepaper that the HKMA has always adopted a risk-based, technology-neutral approach to regulation, with its goal for the two Whitepapers being to help the industry better understand the specific potential of DLT as well as related issues surrounding its implementation. Finally, the HKMA reminded individual organisations deploying DLT that they have a responsibility to strike the right balance between innovation, customer protection and risk management.

The Second DLT Whitepaper confirmed the promising nature of DLT, whilst acknowledging that it cannot be a universal solution for all financial applications. The HKMA noted on its publication that the experts taking part in the research had confirmed that the issues identified in the first whitepaper are valid and that many of them would need new thinking to overcome. Whilst the HKMA noted that the solution will depend on the precise application in question, the Second DLT Whitepaper nonetheless provides broad advice in areas such as the importance of governance structure and its implications on the level of control and liability acceptable to participants, how a hybrid model of DLT and traditional database may be used to resolve the immutable nature of DLT in the storage of personal data, the limits of smart contracts, and the need of adequate security and controls over the operating environment of DLT.

The HKMA sees the next step as being for it to work with the banking industry and the Fintech community to turn the findings and advice in the Second DLT Whitepaper into a set of practical guidelines for the use of DLT in the banking sector in the future.

9. Has any official guidance concerning the use of blockchain technology been published in your jurisdiction?

As noted in the response to question 2 above, the SFC has issued a number of statements and circulars concerning cryptocurrencies and other virtual assets, one of the focuses of which has been to warn investors of the risks inherent in investing in such assets. These are discussed further in the responses to questions 10-16 below.

The key substantive guidance published by the SFC in this area came in the form of a statement and a circular issued on 1 November 2018. Taken together, they set
ou a new regulatory approach for virtual assets, through the regulation of the management and distribution of virtual asset funds, such that investors’ interests are protected at either the fund management level or distribution level or both. The measures do not amend the law or the definitions of “securities” or “futures contracts”, but instead clarify existing requirements and impose new requirements primarily in the form of licensing conditions on intermediaries.

The SFC statement also set out details of a conceptual framework to explore the voluntary regulation of virtual asset trading platform operators, which was followed by the publication on 6 November 2019 of a position paper setting out a new regulatory framework for virtual asset trading platforms.

The SFC statement, circular and position paper are discussed further in the responses to questions 10-16 below.

10. What is the current approach in your jurisdiction to the treatment of cryptocurrencies for the purposes of financial regulation, anti-money laundering and taxation? In particular, are cryptocurrencies characterised as a currency?

The Hong Kong Government and the major Hong Kong regulators, as well as the Hong Kong Police Force, have issued numerous public warnings concerning cryptocurrencies and other virtual assets.

These began with a warning published by the Hong Kong Police Force in 2014 concerning virtual commodities trading and, specifically, Bitcoin. The warning referred to advice from the HKMA that Bitcoin falls outside the regulatory ambit of the HKMA on the basis that it is not considered as legal tender but as a virtual commodity, which is not backed by any physical items, issuers or the real economy, so has no fixed value. The warning noted that: virtual commodities pose considerable security risks to consumers; the possible cyber-security loopholes of Bitcoin trading platforms may lead to the loss of virtual commodities; due to the anonymous nature of virtual commodities transactions, there have been criminals using Bitcoins as a means of money laundering; as Bitcoin is not money, but rather a highly speculative virtual commodity, people should pay more attention to the risk when trading or engaging in related investment activities; and where people come across any property, which they know or suspect to be crime proceeds, they should make a suspicious transaction report (STR) to the Joint Financial Intelligence Unit (JFIU).

This was followed by a statement published on 26 April 2014 by the Money Service Supervision Bureau of the Customs and Excise Department, which is responsible for the regulation money service operators, comprising remittance agents and money changers, under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615 of the Laws of Hong Kong) ("AMLO"). The purpose of the statement was to remind money service operator licence applicants and members of the public that, for the purposes of AMLO, Bitcoin or other similar virtual commodities are not "money" and do not fall within the regulatory regime administered by the Customs and Excise Department.

Next came a press release from the HKMA published on 11 February 2015, noting that the HKMA had reminded the public through the media about the risks involved in Bitcoin trading. The press release reiterated that Bitcoin is not a legal tender but a virtual “commodity” and that as it does not have any backing – either in physical form or from the issuer – and its pricing is highly volatile, it does not qualify as a means of payment or electronic money. The press release concluded that Bitcoin and other similar virtual commodities are not regulated by the HKMA and that given the highly speculative nature of Bitcoin, the HKMA would like to remind the public to exercise extra caution when considering making transactions or investments with Bitcoin.

In a circular to authorized institutions published on 18 March 2018 (the "HKMA BCBS Circular"), the HKMA endorsed the statement on cryptoassets issued by the Basel Committee on Banking Supervision ("BCBS") on 13 March 2019 (the "BCBS Statement"), setting out the BCBS' prudential expectations regarding banks’ exposures to crypto-assets and related services in jurisdictions where banks are involved in such business activities. The HKMA circular noted that as the BCBS explains its statement: cryptoassets do not reliably provide the standard functions of money and are unsafe to rely on as a medium of exchange or store of value; such assets are not regarded as legal tender and are not backed by any government or public authority; and the BCBS is of the view that the continued growth of cryptoasset trading platforms and new financial products related to cryptoassets has the potential to raise financial stability concerns and increase risks faced by banks. The HKMA statement emphasised that it expects authorized institutions to take note of the BCBS’ statement and its prudential expectations, and that authorized institutions planning to engage in activities relating to cryptoassets should discuss with the HKMA and demonstrate that they have put in place appropriate systems and controls to identify and manage any risks associated with such activities. The HKMA’s statement followed similar remarks made by its then-Chief
Executive, Norman T.L. Chan, in his keynote speech on 21 September 2018 at the Treasury Markets Summit 2018: "Crypto-assets and Money" (the "HKMA Cryptoasset Keynote Speech").

The Hong Kong Government has also expressed concern over the risks to the Hong Kong public posed by investments in cryptocurrencies and ICOs. This was reflected in the joint launch, on 29 January 2019, by the FSTB and the Investor Education Centre (IEC), a subsidiary of the SFC, of a public education campaign aimed at providing the public with an understanding of the potential risks of participating in ICOs and cryptocurrency transactions.

As noted in the responses to the questions above, the SFC has also expressed caution in a number of circulars and statements warning investors about the risks of investing in cryptocurrencies and other virtual assets and participating in ICOs and STOs.

The first was a circular published on 16 January 2014, providing guidance to licensed corporations and associated entities on measures to mitigate the money laundering and terrorist financing risks associated with virtual commodities such as Bitcoin. This was followed by another circular on 21 March 2014, drawing attention to the press statement issued by the Hong Kong Government on 14 March 2014 warning the public of various risks associated with any trading or dealing in virtual commodities.

These were followed on 5 September 2017 by the SFC’s statement on ICOs, the purpose of which was to explain that, depending on the facts and circumstances of an ICO, digital tokens that are offered or sold may be “securities” as defined in the SFO, and therefore subject to the securities laws of Hong Kong. More specifically: (i) where digital tokens offered in an ICO represent equity or ownership interests in a corporation, these tokens may be regarded as “shares” (for example, token holders may be given shareholders’ rights, such as the right to receive dividends and the right to participate in the distribution of the corporation’s surplus assets upon winding up); (ii) where digital tokens are used to create or to acknowledge a debt or liability owed by the issuer, they may be considered as a “debenture” (for example, an issuer may repay token holders the principal of their investment on a fixed date or upon redemption, with interest paid to token holders); (iii) if token proceeds are managed collectively by the ICO scheme operator to invest in projects with an aim to enable token holders to participate in a share of the returns provided by the project, the digital tokens may be regarded as an interest in a “collective investment scheme” (“CIS”). Shares, debentures and interests in a CIS are all regarded as “securities”.

The statement went on to explain that where the digital tokens involved in an ICO fall under the definition of “securities”, dealing in or advising on the digital tokens, or managing or marketing a fund investing in such digital tokens, may constitute a “regulated activity”; and that parties engaging in a “regulated activity” are required to be licensed by or registered with the SFC irrespective of whether the parties involved are located in Hong Kong, so long as such business activities target the Hong Kong public. In addition, where an ICO involves an offer to the Hong Kong public to acquire “securities” or participate in a CIS, registration or authorisation requirements under the law may be triggered unless an exemption applies. The statement also noted that parties engaging in the secondary trading of such tokens (e.g. on cryptocurrency exchanges) may also be subject to the SFC’s licensing and conduct requirements; and that certain requirements relating to automated trading services and recognised exchange companies may be applicable to the business activities of cryptocurrency exchanges.

This was followed on 11 December 2017 by an SFC circular on Bitcoin futures contracts and cryptocurrency-related investment products, the primary purposes of which were to remind intermediaries of the legal and regulatory requirements for providing to Hong Kong investors any financial services in relation to Bitcoin futures contracts (“Bitcoin Futures”) and other cryptocurrency-related investment products, as well as to remind investors of the risks associated with these products. The SFC issued a further statement on 6 November 2019 warning investors about the risks associated with the purchase of virtual asset (e.g. Bitcoin) futures contracts, focusing on the fact that they are largely unregulated, highly leveraged and subject to extreme price volatility. The 11 December 2017 circular and the 6 November 2019 statement are discussed further in the response to question 15 below.

On 9 February 2018, the SFC released a statement again alerting investors to the potential risks of dealing with cryptocurrency exchanges and investing in ICOs. The statement disclosed that the SFC had sent letters to seven cryptocurrency exchanges in Hong Kong or with connections to Hong Kong warning them that they should not trade cryptocurrencies which are “securities” as defined in the SFO without a licence. The statement disclosed that the SFC had also written to seven ICO issuers. Finally, the statement noted that whilst the SFC may not have jurisdiction over cryptocurrency exchanges and ICO issuers if they have no nexus with Hong Kong or do not provide trading services for cryptocurrencies which are “securities” or “futures
contracts” as defined in the SFO, if there is suspicion of fraud the SFC is open to refer cases to the Hong Kong Police Force for investigation.

On 28 March 2019, the SFC published a statement on STOs, again reminding investors to be wary of the risks associated with virtual assets, but this time focusing on tokens which are the subject of STOs (“Security Tokens”). This is discussed further in the response to question 15 below.

Whilst some have expressed the view that the SFC has at times overreached in its proclamations concerning types of virtual assets or ICOs / STOs which fall outside the scope of its regulatory jurisdiction, the general consensus is that it has acted in a manner consistent with its functions as a front-line financial regulator in Hong Kong, in particular that of investor protection. The SFC’s approach to the regulation of activities relating to virtual assets falling within the scope of its regulatory jurisdiction is discussed below.

As described in the response to question 5 above, on 1 November 2018 the SFC published a circular on the distribution of virtual asset funds (the “November 2018 Circular”) and a statement on a regulatory framework for virtual asset portfolio managers, fund distributors and trading platform operators (the “November 2018 Statement”), which together set out a new regulatory approach for virtual assets. The new measures aim to regulate the management and distribution of virtual asset funds so that investors’ interests are protected at either the fund management level or distribution level or both. The measures do not, however, amend the law or the definitions of “securities” or “futures contracts”. Instead they clarify existing requirements and impose new requirements primarily in the form of licensing conditions on intermediaries.

- The purpose of the November 2018 Circular is to: (i) remind intermediaries licensed or registered for Type 1 regulated activity (dealing in securities) or Type 9 regulated activity (asset management), to the extent that these intermediaries are engaged in distributing virtual asset funds under their management, about the existing regulatory requirements; and (ii) provide guidance on the expected standards and practices in relation to the distribution of virtual asset funds. The key takeaways are summarised below. Distributors of collective investment schemes (“Funds”), typically being mutual funds or unit trusts, are required to be licensed by the SFC for Type 1 (dealing in securities) regulated activity, unless an exemption applies. The distribution of Funds that invest in virtual assets, including cryptocurrencies, is therefore regulated (regardless of whether or not the virtual assets contained in the Funds are “securities” or “futures contracts” as defined under the SFO). Distributors (including asset managers distributing under the incidental exemption) are already required under paragraph 5.2 of the SFC Code to ensure the suitability of any recommendation or solicitation to a client is reasonable. This is subject to certain exemptions, in particular institutional professional investors (as defined in the SFC Code). The November 2018 Circular provides that, in addition, where a Fund: (i) is not authorised by the SFC for distribution to retail clients (non-authorised); and (ii) has a stated investment objective to invest in virtual assets, or intends to or has invested more than 10% of gross asset value in virtual assets (directly or indirectly e.g. derivatives with virtual assets as underlying), then SFC licensed distributors should adhere to enhanced selling restrictions (targeting professional investors only, assessment of investor knowledge of virtual assets, and ensuring that the amount invested by a client into non-authorised virtual asset Funds is reasonable considering the client’s net worth), due diligence (on the Fund, its manager and its counterparties) and information to be provided to clients (in a clear and easily comprehensible manner, and accompanied by a number of specified warning statements).

- The primary purpose of the November 2018 Statement is to provide guidance on the regulatory standards expected of virtual asset portfolio managers and fund distributors, in order to address the significant risks associated with investing in virtual assets. The key takeaways are summarised below. The November 2018 Statement explains that the SFC supervises the following types of virtual asset portfolio managers: (i) managers who manage and distribute a Fund that invests in virtual assets (including managers who do not require a Type 9 (asset management) licence because the Fund does not invest in “securities” or “futures contracts” as defined under the SFO, but who distribute the Fund and hence require a Type 1 (dealing in securities) licence, unless an exemption applies); and (ii) managers who are asset managers of a Fund that holds “securities” or “futures contracts” as defined under the SFO (and who therefore require a Type 9 (asset
management) licence to manage such securities or futures contracts). Where such managers falling within (i) or (ii) above manage portfolios which invest solely or partly in virtual assets that are not “securities” or “futures contracts” as defined under the SFO, such management will be subject to SFC oversight through the imposition of licensing conditions. This oversight is subject to a de minimis threshold that the Fund has a stated investment objective to invest in virtual assets, or there is an intention to invest 10% or more of the gross asset value of the Fund portfolio in virtual assets (the “De Minimis Threshold”). The managers falling within (i) or (ii) above should observe essentially the same regulatory requirements, regardless of whether or not the Fund invests in virtual assets. With this in mind, the SFC has developed a set of ‘Terms and Conditions’ for licensed corporations, capturing the essence of the existing requirements, adapted as needed in the context of virtual assets. They will likely be imposed as licensing conditions, subject to minor variations depending upon the particular asset manager. As well as the De Minimis Threshold exemption, the Terms and Conditions will also not apply to licensed corporations which only manage fund of funds that have portfolios investing in virtual asset funds. Some of the key Terms and Conditions are set out in Appendix 1 to the November 2018 Statement.

- The November 2018 Statement also set out (in Appendix 2) details of a conceptual framework to explore the regulation, on a voluntary basis, of virtual asset trading platform operators. Those platforms that become regulated and thereby adhere to a high level standards and practices would be set aside from unlicensed operators. Such interested platforms would first be placed in the SFC Regulatory Sandbox for observance by the SFC (which would include assessing whether the platform is indeed appropriate to the regulated by the SFC, and whether inherent risks can be appropriately dealt with).

Building on the key Terms and Conditions set out in Appendix 1 to the November 2018 Statement, on 4 October 2019 the SFC published more detailed proforma terms and conditions for virtual asset portfolio managers (the “Proforma Terms and Conditions”). The Proforma Terms and Conditions will be imposed as licensing conditions on licensed corporations that manage a fund (or portion of a fund) that invests in “Virtual Assets” as defined in the Proforma Terms and Conditions and which meet the De Minimis Threshold. The Proforma Terms and Conditions define “Virtual Assets” as: “digital representations of value which may be in the form of digital tokens (such as digital currencies, utility tokens or security or asset backed tokens), any other virtual commodities, crypto assets or other assets of essentially the same nature, irrespective of whether they amount to “securities” or “futures contracts” as defined under the SFO”.

The key areas covered by the Proforma Terms and Conditions include:

(i) general principles (similar to those under the Code of Conduct for Persons Licensed by or Registered with the SFC (the “SFC Code”)) but tailored for virtual assets; (ii) organisation and management structure (including detailed risk management control techniques and procedures at Appendix 2); (iii) virtual asset fund management; (iv) custody of fund assets and client money; (v) operations; (vi) dealing with the fund and fund investors (including provision of adequate information to investors); (vii) marketing activities (including only allowing professional investors to invest in Virtual Asset funds (other than other than collective investment schemes authorised by the SFC)); (viii) fees and expenses; and (ix) reporting to the SFC.

Contravention of a licensing condition is likely to be considered as misconduct under the SFO which will reflect adversely on the fitness and properness of a Virtual Asset fund manager to remain licensed and may result in disciplinary action by the SFC. However, the SFC notes that it will adopt a pragmatic approach taking into account all relevant circumstances, including the size of the Virtual Asset fund manager and any compensatory measures implemented by its senior management.

On 3 April 2020, Venture Smart Asia Limited (“VSAL”), which had held Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activity licenses from the SFC since 2015, became the first asset manager to be approved by the SFC as a virtual asset portfolio manager via the imposition of the Proforma Terms and Conditions. On 20 April 2020, Arrano Capital, the blockchain arm of VSAL, announced the launch of the first cryptocurrency fund in Hong Kong to have an advisor and distributor – i.e. VSAL – that is licensed and approved by the SFC. The fund comprises Digitrackers SPC and its first Segregated Portfolio, Digitrackers Bitcoin SP, a Cayman Islands exempted limited segregated portfolio company and segregated portfolio respectively. Arrano Capital acts as offshore adviser to the fund, whilst VSAL acts as onshore advisor and distributor.
Appendix 2 to the November 2018 Statement, on 6 November 2019 the SFC published a position paper setting out a new regulatory framework for virtual asset trading platforms (the “opt-in regime”). Like the original conceptual framework, the opt-in regime effectively applies on a voluntary basis. This is achieved under the opt-in regime by platform operators who wish to be licensed ensuring that they offer trading on their platform of at least one “security token” – being virtual assets which fall within the definition of “securities” under the SFO. This means that the platform operator will fall within the regulatory jurisdiction of the SFC and require a licence for Type 1 (dealing in securities) and Type 7 (providing automated trading services) regulated activities. The position paper emphasises that the SFC will only grant licences to platform operators which are capable of meeting robust regulatory standards, being standards comparable to those which apply to licensed securities brokers and automated trading venues but which also incorporate additional requirements to address specific risks associated with virtual assets. For example, the SFC will impose licensing conditions requiring that platform operators offer their services exclusively to professional investors, only service clients who have sufficient knowledge of virtual assets and maintain stringent criteria for the inclusion of virtual assets on their platforms. In addition, licensed platforms will be placed in the SFC Regulatory Sandbox for a period of close and intensive supervision. However, the position paper also makes it clear that, even if the SFC licenses and supervises a virtual asset trading platform, the non-“security token” virtual assets traded on the platform are not subject to the authorisation or prospectus registration provisions that apply to traditional offerings of securities or collective investment schemes. Moreover, the SFC has no power to grant a licence to or supervise platforms which only trade virtual assets or tokens which are not “security tokens”.

On 21 August 2020, OS Limited (OSL), a subsidiary of BC Technology Group Ltd (an investment holding company listed on the Hong Kong Stock Exchange), announced that it had received an approval-in-principle for its application to the SFC to operate a virtual asset trading platform under licenses for Type 1 (dealing in securities) and Type 7 (automated trading service) regulated activities. The announcement explains that once the conditions for final approval are satisfied, the licenses will permit OSL to operate a brokerage and automated trading service for digital assets, including security tokens. In an endorsement of the SFC’s new regulatory framework for virtual asset trading platforms under the opt-in regime, the announcement goes on to state that: “The SFC framework continues to be the only licensing framework within the top international financial centers that fully integrates the specific requirements for digital asset platforms alongside traditional rigorous securities regulations. Because of this unique integrated framework, clients of a Hong Kong licensed digital asset trading platform can enjoy all the protections and safeguards they have become accustomed to in traditional finance, and can also take comfort in additional protections under the new regime that have been tailor-made for the new asset class.”

On 3 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 virtual asset services providers (“VASPs”). This ties in with the Financial Action Task Force’s revision of its Standards in February 2019, under Recommendation 15, to require jurisdictions to regulate (or prohibit) VASPs for AML/CTF purposes in the same way as financial institutions. For now, the VASP licensing regime will only apply to “VA exchanges” (as defined below), and not to other VASP activities (such as virtual asset payment systems or custodian services), as those are not prevalent in Hong Kong. In May 2021, the FSTB published the consultation conclusions to the public consultation. Based on these consultation conclusions, the FSTB will proceed to prepare the amendment bill to the AMLO, which is planned to be introduced to the Hong Kong Legislative Council in the 2021-22 legislative session. According to the consultation conclusions, a “virtual asset”, or “VA”, will be defined to mean 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 does not cover digital representations of fiat currencies (including digital currencies issued by central banks); financial assets (e.g. securities and authorized structured products) already regulated under the SFO; or closed-loop, limited purpose items that are non-transferable, non-exchangeable and non-fungible (e.g. air miles, credit card rewards, gift cards, customer loyalty programmes, gaming coins etc.). Virtual assets purportedly backed by some form of assets for the purpose of stabilising their value (commonly known as “stablecoins”) would however be caught. To allow for flexibility, in light of the fast-evolving nature of VAs, the amendment bill will also empower the SFC to prescribe characteristics that constitute the definition of a VA, and the Secretary for Financial Services and the Treasury to determine (either generally or in a particular case) whether any digital representation of value is to be regarded as a VA or not. A “VA exchange” is defined to mean any trading platform which is operated for the purpose of allowing an offer or invitation to be made to
buy or sell any VA in exchange for any money or any VA, and which comes into custody, control, power or possession of, or over, any money or any VA at any point in time during its course of business. Peer-to-peer trading platforms (i.e. platforms that only provide a forum where buyers and sellers of VAs can post their bids and offers, with or without automatic matching mechanisms, for the parties themselves to trade at an outside venue), to the extent 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 any VA at any point in time, are not covered under the definition of “VA exchange”. Any person seeking to operate a VA exchange must apply for a licence from the SFC under AMLO. Only locally incorporated companies with a permanent place of business in Hong Kong or companies incorporated overseas but registered in Hong Kong under the Companies Ordinance (Cap.622) will be permitted to apply for a VASP licence. Applicants, their responsible officers and ultimate owners must satisfy a ‘fit and proper’ test (including experience and relevant qualification requirements). A licensed VA exchange will also be required to observe the AML/CTF requirements under Schedule 2 to AMLO that apply to financial institutions. A licensed VASP can only offer services to professional investors (although the FSTB did note it will review the position in relation to retail investors as the market becomes more mature in future) and must impose rigorous criteria for the inclusion of VAs to be traded on its platform. A licensed VASP should also meet the prescribed regulatory requirements concerning financial resources, knowledge and experience, soundness of the business, risk management, segregation and management of client assets, financial reporting and disclosure, prevention of market manipulative and abusive activities, and prevention of conflicts of interest. The SFC will prepare and publish for consultation the detailed regulatory requirements before commencement of the licensing regime, with a view to providing more guidance for the industry on the regulatory expectations. A VA exchange that is already regulated as a licensed corporation under the opt-in regime will be exempt from the VASP licensing regime. After a transition period, proposed to be 180 days after commencement of operation of the VASP licensing regime, all operators carrying on VA exchange business must possess a valid licence issued by the SFC. The regime will also prohibit a person, whether in Hong Kong or elsewhere, from actively marketing to the Hong Kong public a regulated VA activity or associated services, unless that person is properly licensed and regulated by the SFC to carry out the regulated VA activity.

On 27 March 2020, the Hong Kong Inland Revenue Department (“IRD”) published a revised version of Departmental Interpretation and Practice Note No. 39, renamed ‘Profits tax – Digital Economy, Electronic Commerce and Digital Assets’ ("DIPN 39"), which includes a new section on digital assets. This provides that, broadly, the profits tax treatment of digital assets will depend on their nature and use. Some more specific illustrations of this general principle in the context of different types of digital assets / transactions are summarised below.

- **ICOs:** The IRD would review the white paper or any other underlying documents of an ICO and examine what rights and benefits (e.g. equity interests or a right to access to a future service similar to a voucher) are attached to the digital tokens. From the perspective of the issuer, the tax treatment of the proceeds from an ICO generally follows from the attributes of the tokens that are issued. It is the nature of the rights and obligations of the tokens, not the form in which the tokens are issued, that determine the tax treatment.

- **Digital assets held for investment:** Profits arising from the sale of capital assets are excluded from the charge of profits tax. If digital assets are bought (e.g. through ICO or exchange platform) for long-term investment purposes, any profits from disposal would not be chargeable to profits tax. Whether the digital assets are capital assets or trading stock has to be considered on the basis of the facts and circumstances. Well-established tax principles like the “badges of trade” would continue to be applicable and the intention at the time of acquisition of the digital assets is always relevant to decide whether they are capital assets or trading stock.

- **Cryptocurrency:** Hong Kong sourced profits from cryptocurrency business activities are chargeable to profits tax. In deciding the source of profits, it is necessary to ascertain the nature of the profits in question, the person’s relevant operations that produced the profits in question and the place where those profit-generating operations were carried out – i.e. the usual principles will apply. The question whether the buying and selling of cryptocurrency, exchange of cryptocurrency 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 a consideration of all the circumstances. Factors such as the degree and frequency of the activity, the level of system or organisation (i.e. whether the activity is undertaken in a business-like
manner) and whether the activity is done for the purpose of making a profit are relevant considerations.

11. Are there any prohibitions on the use or trading of cryptocurrencies in your jurisdiction?

Although the use or trading of cryptocurrencies is not prohibited in Hong Kong, the Hong Kong Police Force, as well as a number of Hong Kong regulators including the HKMA, the SFC and the Customs and Excise Department, have published statements or circulars warning investors of the risks associated with investing in or trading in cryptocurrencies, as described in the response to question 10 above.

In addition, the SFC’s statements on ICOs published on 5 September 2017 and 9 February 2018 respectively warned market participants that, depending on the facts and circumstances of an ICO, digital tokens that are offered or sold may be “securities” as defined in the SFO, and therefore subject to the securities laws of Hong Kong. The latter statement also disclosed that the SFC had sent letters to seven cryptocurrency exchanges in Hong Kong or with connections to Hong Kong warning them that they should not trade cryptocurrencies which are “securities” as defined in the SFO without a licence. The statement also disclosed that the SFC had written to seven ICO issuers.

In March 2018, the SFC confirmed that ICO issuer Black Cell Technology Limited (“Black Cell”) had halted its ICO to the Hong Kong public and agreed to unwind ICO transactions for Hong Kong investors by returning them the relevant tokens, following regulatory action by the SFC over concerns that Black Cell had engaged in potential unauthorized promotional activities and unlicensed regulated activities. In addressing SFC’s regulatory concerns, Black Cell agreed not to devise, set up or market any scheme that constitutes a CIS unless in compliance with the relevant requirements under the SFO. This followed the SFC’s finding that Black Cell had promoted an ICO to sell digital tokens to investors through its website accessible by the Hong Kong public, with the pitch that the ICO proceeds would be used to fund the development of a mobile application and holders of the tokens would be eligible to redeem equity shares of Black Cell. The SFC considered that the arrangement may constitute a CIS.

The FSTB is preparing the amendment bill to the AMLO, which it plans to introduce to the Hong Kong Legislative Council in the 2021-22 legislative session. The proposed amendment bill will prohibit a person, whether in Hong Kong or elsewhere, from actively marketing to the Hong Kong public a regulated VA activity or associated services, unless that person is properly licensed and regulated by the SFC to carry out the regulated VA activity (see the response to question 10 above for further detail).

12. To what extent have initial coin offerings taken place in your jurisdiction and what has been the attitude of relevant authorities to ICOs?

Hong Kong has emerged as a leading Asian ICO hub, likely due in part to the People’s Bank of China’s announcement in September 2017 of an outright ban on ICOs in China.

According to a joint report published in January 2020 by PricewaterhouseCoopers (“PwC”) and Crypto Valley, Hong Kong was one of the leading token offering jurisdictions worldwide throughout 2018 and 2019 (as at 31 October 2019) in terms of funding volume and number of completed offerings, along with the USA, Singapore and the UK. The report also ranked Hong Kong as the leading jurisdiction for token offerings globally in 2019 by total funds raised (as at 31 October 2019), with a total of USD1,009 million raised through 4 closed offerings. However, this was accounted for primarily by the USD1,000 million raised by cryptocurrency exchange Bitfinex in May 2019.

In addition to Bitfinex, other notable examples of successful Hong Kong ICOs include: Gatcoin, which offers a solution for businesses to transform their traditional discount coupons, shopping vouchers and loyalty points into digital tokens, and which raised US$14.5 million in January 2018; AirSwap, which is developing a decentralized cryptocurrency marketplace and which raised US$36 million in October 2017; and the OAX Foundation, which is building a decentralized cryptocurrency exchange platform and which raised US$18 million in July 2017.

13. If they are permissible in your jurisdiction, what are the key requirements that an entity would need to comply with when launching an ICO?

The SFC’s statement on ICOs published on 5 September 2017 (referred to in the response to question 10 above) explained that where the digital tokens involved in an ICO fall under the definition of “securities”, dealing in or advising on the digital tokens, or managing or marketing a fund investing in such digital tokens, may constitute a “regulated activity”; and that parties engaging in a
"regulated activity" are required to be licensed by or registered with the SFC irrespective of whether the parties involved are located in Hong Kong, so long as such business activities target the Hong Kong public.

In addition, where an ICO involves an offer to the Hong Kong public to acquire "securities" or participate in a CIS, registration requirements under the prospectus regime contained in Part II and Part XII of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32 of the Laws of Hong Kong) (in the case of an offer to the Hong Kong public to acquire "securities") or authorisation requirements under Part IV of the SFO (in the case of an issue of offering documents of a collective investment scheme to the public of Hong Kong) may be triggered unless an exemption applies.

The statement also noted that parties engaging in the secondary trading of such tokens (e.g. on cryptocurrency exchanges) may also be subject to the SFC’s licensing and conduct requirements; and that certain requirements relating to automated trading services and recognised exchange companies may be applicable to the business activities of cryptocurrency exchanges.

Note also that any distributor which is regulated by the SFC is subject to fit and proper requirements, which extend beyond the scope of its regulated activities and so may well cover an ICO product.

14. Is cryptocurrency trading common in your jurisdiction? And what is the attitude of mainstream financial institutions to cryptocurrency trading in your jurisdiction?

As described in the response to question 12 above, a joint report published in January 2020 by PwC and Crypto Valley ranked Hong Kong as one of the leading token offering jurisdictions worldwide throughout 2018 and 2019 (as at 31 October 2019) in terms of funding volume and number of completed offerings, along with the USA, Singapore and the UK.

According to a March 2019 report by CryptoCompare, a global digital currency data provider, Hong Kong ranked second globally for monthly cryptocurrency trading by volume in March 2019, based on legal jurisdiction of exchange, with US$53.1 billion worth of cryptocurrencies traded.

Local interest in cryptocurrencies saw a surge in the third quarter of 2019, with local peer-to-peer Bitcoin trading platform LocalBitcoins reportedly recording its highest ever weekly trading volume (in excess of HK$12 million) in the final week of September. The spike was reported by some sections of the media as being linked to the anti-government protests that started in June 2019 in response to a controversial China-sponsored extradition bill, and more specifically a perception that the Hong Kong Government had been tracking digital payment habits to follow the protestors, prompting people to switch to physical cash (demonstrated by reports of ATMs across the city running out of money) and cryptocurrencies. Since the spike in September 2019, weekly trading volumes have reduced, fluctuating between approximately HK$1 million and HK$4.3 million in the first three quarters of 2020.

The relative public appeal of cryptocurrencies can be contrasted with the generally cool reception to cryptocurrency trading amongst mainstream financial institutions in Hong Kong. This has been shaped in part by the attitude of the HKMA, as evidenced by the HKMA BCBS Circular published on 18 March 2018, in which the HKMA stated that authorized institutions planning to engage in activities relating to cryptoassets should discuss with the HKMA and demonstrate that they have put in place appropriate systems and controls to identify and manage any risks associated with such activities.

15. Are there any relevant regulatory restrictions or initiatives concerning tokens and virtual assets other than cryptocurrencies (e.g. trading of tangible property represented by cryptographic tokens)?

On 11 December 2017, the SFC published a circular on Bitcoin Futures and cryptocurrency-related investment products (referred to in the response to question 10 above), the primary purpose of which was to remind intermediaries of the legal and regulatory requirements for providing to Hong Kong investors any financial services in relation to Bitcoin Futures and other cryptocurrency-related investment products and the risks associated with these products. The circular was primarily in response to the launch of Bitcoin Futures on the Chicago Mercantile Exchange (CME), which is authorised by the SFC to provide automated trading services, meaning that Hong Kong investors may be able to trade in Bitcoin Futures through an intermediary which is a member of CME. The circular noted that Bitcoin Futures have the conventional features of a “futures contract” as defined in the SFO. Therefore, even though the underlying assets of Bitcoin Futures are not regulated under the SFO, Bitcoin Futures traded on and subject to the rules of those exchanges are regarded as “futures contracts” for the purposes of the SFO. Accordingly, parties carrying on a business in dealing in
Bitcoin Futures, including those who relay or route Bitcoin Futures orders, are required to be licensed for Type 2 regulated activity (dealing in futures contracts) under the SFO unless an exemption applies. The SFC also expects that intermediaries should strictly observe the suitability requirement and the conduct requirements in relation to providing services in derivative products to clients under the SFC Code. In addition, marketing a fund investing in Bitcoin Futures will normally constitute Type 1 regulated activity (dealing in securities) and managing such a fund may constitute Type 9 regulated activity (asset management). The provision of advisory services in relation to Bitcoin Futures may also constitute Type 5 regulated activity (advising on futures contracts).

As described in the response to question 10 above, the SFC issued a further statement on 6 November 2019 warning investors about the risks associated with the purchase of virtual asset (e.g. Bitcoin) futures contracts, focusing on the fact that they are largely unregulated, highly leveraged and subject to extreme price volatility. The statement also notes that there have been reports of market manipulative and abusive activities on platforms offering or trading virtual asset futures contracts and that such platforms may not have clear and fair trading rules, with some platforms having been criticised by investors for changing their trading rules during the life of futures contracts, for example halting trades or rolling back transactions and causing significant losses to investors. The statement cautions that any trading platforms or persons which offer and/or provide trading services in virtual asset futures contracts in Hong Kong without a proper licence or authorisation may be in contravention of the SFO (if the virtual asset futures contracts are "futures contracts" as defined under the SFO) or the Gambling Ordinance (Cap. 148 of the Laws of Hong Kong) (if the virtual asset futures contracts are "contracts for differences" as defined under the Gambling Ordinance).

On 28 March 2019, the SFC published a statement on STOs (also referred to in the response to question 10 above), again reminding investors to be wary of the risks associated with virtual assets, but this time focusing on Security Tokens. The circular explains that STOs typically refer to specific offerings which are structured to have features of traditional securities offerings and involve 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. It goes on to explain that Security Tokens are normally offered to professional investors only and that in Hong Kong, they are likely to be "securities" as defined under the SFO and therefore subject to the securities laws of Hong Kong. Where Security Tokens are “securities” as defined under the SFO, then unless an applicable exemption applies, any person who markets and distributes Security Tokens (whether in Hong Kong or targeting Hong Kong investors) is required to be licensed or registered for Type 1 regulated activity (dealing in securities) under the SFO. Intermediaries which market and distribute Security Tokens are required to ensure compliance with all existing legal and regulatory requirements. In particular, they should comply with paragraph 5.2 of the SFC Code as supplemented by the Frequently Asked Questions on Compliance with Suitability Obligations by Licensed or Registered Persons and the Frequently Asked Questions on Triggering of Suitability Obligations. Under the Guidelines on Online Distribution and Advisory Platforms and paragraph 5.5 of the SFC Code, Security Tokens would be regarded as “complex products” and therefore additional investor protection measures also apply. In addition, intermediaries are expected to observe requirements which are similar to those set out in the SFC’s circular on the distribution of virtual asset funds published on 1 November 2018 and described in the response to question 10 above, namely enhanced selling restrictions, due diligence and information to be provided to clients.

16. Are there any legal or regulatory issues concerning the transfer of title to or the granting of security over tokens and virtual assets?

The question of the extent to which legally effective transfers of title to, or granting of security over, legal tokens and virtual assets can be achieved will depend primarily on whether such tokens and virtual assets constitute “property” under Hong Kong law. To date, there has been very limited legal, regulatory or judicial consideration of this question, likely reflecting both the relative infancy of these asset types and the wide potential variance of characteristics between them.

Hong Kong is likely to follow the approach of other common law jurisdictions in this regard, which traditionally recognise property as either real property or personal property, with all personal property being either a chose in possession or a chose in action. These categorisations present difficulties when applied to tokens and virtual assets, which (in some cases at least) may exist solely in the form of information or data on a distributed ledger or blockchain, as opposed to being tangible (i.e. a chose in possession) or being legal rights capable of being enforced (i.e. a chose in action). Where the holders of tokens and virtual assets are given some form of right, then the Hong Kong courts should regard that right as a form of property.
Recent court decisions in other common law jurisdictions such as England and Singapore support the view that tokens and virtual assets may be recognised as property, notwithstanding that they may not sit easily within the traditional common law categories referred to above. See for example the 2012 case of Armstrong DLW GmbH v Winnington Network Ltd in the High Court of England and Wales, which recognised EU carbon trading allowances as property under English law; and the 2019 case of B2C2 Ltd v Quoine Pte Ltd in the Singapore International Commercial Court, which recognised virtual currencies as property under Singapore law.

In November 2019 the UK Jurisdiction Taskforce published a ‘Legal statement on cryptoassets and smart contracts’ which concluded that in general cryptoassets are to be treated in principle as property. We expect the statement to be persuasive when the Hong Kong courts consider the point.

Where tokens and virtual assets do constitute property under Hong Kong law, then it should be possible (subject to the terms of such assets) to transfer legal title to, and to grant security over, such assets in the same way as other intangible property.

17. 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, provides that a smart contract may be considered as an arrangement whereby autonomous software running on a DLT platform automatically exchanges assets that are stored or represented on the DLT platform (e.g. the delivery vs payment arrangement). Whether a smart contract can be considered as a legal contract is still an open debate. However, the notion that smart contracts can be used to completely replace legal contracts or govern the relationships between participants in a DLT platform is misguided. Using a smart contract without explicit contractual terms could cause uncertainty for participants in the event of unforeseen consequences or disputes.

The Second DLT Whitepaper points to the 2016 Decentralised Autonomous Organisation (“DAO”) Ethereum hack as a wake-up call and a reminder that programming/modelling errors and complex contract interdependencies can give rise to the risk of smart contracts failing to reflect the intention of the creator. 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.

The Annex to the Second DLT Whitepaper drafted by the Technology Committee of The Law Society of Hong Kong provides further elaboration on the concepts described above. Its starting point is that whilst smart contracts may have the effect of a contract, they take on many forms and should not be understood simply as contractual documents in digital form. Whilst a smart contract usually contains the mechanics for execution, performance and enforcement, it may not contain the entirety of terms forming the contract at law. The relevant question is therefore what sort of legal remedies are sought and under what claims. If a party desires to seek contractual remedies and enforce the smart contract as a contract at law, then the common law contract requirements would need to be proven to have existed contemporaneously during the purported contractual relationship between the relevant parties. There may, however, be other ways to characterise the smart contract and its relationships with the relevant stakeholders, which could give rise to legal recourse. This might be founded on a legal binding contract, such as securities trading on exchange or DAO, or some other grounds, such as negligence, restitution and fiduciary duty. The remedy of unjust enrichment – often associated with mistakes of fact or law, total failure of consideration, duress and undue influence – might be available in the case of the restitution of unjust gains resulting from a breach of a smart contract. The bottom line, however, is that given the underlying risks of modelling errors and complex contract interdependencies, the performance of each smart contract carries the risk of failing to reflect the intentions of its creators. The Law Society therefore recommends 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.

18. To what extent are smart contracts in use in your jurisdiction? Please mention any key initiatives concerning the use of
smart contracts in your jurisdiction, including any examples relating to decentralised finance protocols.

The HKMA noted in the Second DLT Whitepaper that smart contracts "have been singled out as requiring additional attention due to their huge potential for automating transactions in DLT".

Smart contracts played a prominent role in one of the three use cases selected by the HKMA for PoC development in the First DLT Whitepaper, the results of which were reported on in the Second DLT Whitepaper – namely the trade finance PoC use case. The Second DLT Whitepaper reported that smart contracts had been used in a number of areas, namely: (i) to store the status of a transaction with a stated data structure so that enquiries can be made quickly; (ii) to distribute event-triggered logic among nodes so that finance can be provided to customers more promptly based on “triggering events” built into the smart contract; and (iii) to reconcile purchase orders and invoices automatically in the DLT network.

On 31 October 2018, the HKMA announced the official launch of eTradeConnect, a blockchain-based trade finance platform developed by a consortium of twelve major banks in Hong Kong. Formerly known as the Hong Kong Trade Finance Platform, eTradeConnect aims to improve trade efficiency, build better trust among trade participants, reduce risks and facilitate trade counterparties to obtain financing by digitising trade documents, automating trade finance processes and leveraging the features of blockchain technology. In order to facilitate cross-border trades, the HKMA has been proactively looking for opportunities to connect eTradeConnect with trade platforms in other regions. On 31 October 2018, eTradeConnect announced the signing of a Memorandum of Understanding with we.trade to conduct a Proof-of-Concept (“PoC”) trial on connecting the two platforms. we.trade, the first blockchain-based trade finance platform in Europe, based on the IBM Blockchain Platform, is a joint venture launched in June 2018 between what is now 16 European banks and which currently provides client coverage across 15 European countries. On 6 November 2019 a Memorandum of Understanding was signed between the subsidiaries of Hong Kong Interbank Clearing Limited and the Institute of Digital Currency of the People’s Bank of China (“PBoC”) to conduct a PoC trial which aims to connect eTradeConnect and the PBoC Trade Finance Platform.

On 22 January 2020, the HKMA and the Bank of Thailand (“BOT”) published a report on a joint Central Bank Digital Currency (“CBDC”) research project named Project Inthanon-LionRock. As a follow-up to the Memorandum of Understanding signed between the HKMA and the BOT in May 2019, the two authorities initiated Project Inthanon-LionRock to study the application of CBDC to cross-border payments. A THB-HKD cross-border corridor network prototype was developed, allowing participating banks in Hong Kong and Thailand to conduct funds transfers and foreign exchange transactions on a peer-to-peer basis, which helps reduce settlement layers. Leveraging on smart contracts, the cross-border funds transfer process is enhanced to a real-time and atomic payment-versus-payment (PvP) model. Project Inthanon-LionRock was completed in December 2019 and a DLT based PoC prototype was developed successfully together with ten participating banks from the two jurisdictions. The key findings of the project are presented in the 22 January 2020 report, which covers topics including token conversion, real-time interbank funds transfer, foreign exchange execution, liquidity management and regulatory compliance. The two authorities agreed to proceed with further joint research work in relevant areas, including exploring business cases and connections to other platforms, involving participation of banks and other relevant parties in cross-border funds transfer trials.

Project Inthanon-LionRock entered the second phase in 2020 and was subsequently renamed to Multiple CBDC Bridge (mBridge) in February 2021, when it was joined by the Central Bank of the United Arab Emirates and the Digital Currency Institute of the PBoC, and strongly supported by the BIS Innovation Hub Centre in Hong Kong

Building on the knowledge and experience in wholesale CBDC, in June 2021, the HKMA commenced Project e-HKD, which is a retail or general-purpose CBDC (rCBDC) project that aims to study the feasibility of e-HKD (see the response to question 7 above for further detail).

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

As described in the response to question 11 above, the SFC’s statement published on 9 February 2018 noted that the SFC had sent letters to seven cryptocurrency exchanges in Hong Kong or with connections to Hong Kong warning them that they should not trade cryptocurrencies which are “securities” as defined in the SFO without a licence. The statement also noted that the SFC had written to seven ICO issuers.

In addition, 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 by returning them the relevant tokens, following regulatory action by SFC over concerns that Black Cell had engaged in potential unauthorized promotional activities and unlicensed regulated activities (also discussed in the response to question 11 above).

In February 2019, the Hong Kong Police Force arrested 25-year-old Wong Ching-kit, better known as “Coin Young Master”, and his 20-year-old colleague for conspiracy to defraud investors in so-called cryptocurrency ‘mining machines’ sold by the pair relating to the cryptocurrency ‘Filecoin’.

20. Has there been any judicial consideration of blockchain concepts or smart contracting in your jurisdiction?

There has been very limited judicial consideration of blockchain concepts or smart contracting in Hong Kong to date.

However, given Hong Kong’s increasing prominence as an Asian (and indeed global) ICO hub and local interest in cryptocurrency trading (discussed in the responses to questions 12 and 14 above), combined with well-publicised governmental and regulatory scrutiny of cryptocurrency trading and ICO / STO issuances (discussed in the responses to questions 10 and 15 above), future judicial consideration in this area seems likely.

21. Are there any other generally-applicable laws or regulations that may present issues for the use of blockchain technology (such as privacy and data protection law or insolvency law)?

As described in the response question 5 above, the HKMA’s Second DLT Whitepaper, published on 25 October 2017, identified 7 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 model and liability of participants); (vi) competition / anti-trust laws (fair competition and anti-trust 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 explains that the three key characteristics of DLT that need addressing under the Personal Data (Privacy) Ordinance (Cap. 486 of the Laws of Hong Kong) are, first, the accessibility of some DLT platforms, in which all nodes have equal access to all stored personal data regardless of whether they need to see it; second, the immutability of stored data, whereby data cannot be amended or erased; and third, the often cross-border nature of DLT, meaning that personal data may be stored outside Hong Kong. The Second DLT Whitepaper concludes that the simplest way to address privacy concerns would seem to be to avoid storing personal data in the ledger, but rather only keep the hashes of personal data in it. Storing personal data off the ledger in more conventional databases while keeping hashes in the ledger could continue to ensure data integrity while controlling and limiting access to personal data.

In addition to the legal issues referred to in the Second DLT Whitepaper, the use of blockchain technology, in particular cryptocurrencies and other virtual assets, raises obvious AML and CTF concerns given the unregulated nature of many parts of this industry. As noted by the HKMA’s then-Chief Executive, Norman T.L. Chan, in the HKMA Cryptoasset Keynote Speech on 21 September 2018, because many cryptoassets are so designed that anonymous email accounts can be used for trading and transfers without a central clearing agent, they effectively bypass the existing regime in combatting money laundering, terrorist financing and other illicit activities. The ease with which cryptoassets can be transferred across national borders had made it even more attractive to criminals in laundering their proceeds and income, Mr Chan remarked, with the result that for the banks and other regulated financial institutions, it was proving difficult, if not impossible, for them to comply with the statutory or supervisory requirements in respect of know-your-customer (KYC) or ascertaining the source of funds.

Cryptocurrencies and other virtual assets also present potential problems in the context of insolvency law, in particular with respect to asset tracing.

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

As explained in BCBS Statement published on 13 March 2019 and referred to in the HKMA Cryptoasset Keynote Speech (discussed in the response to question 10 above), the BCBS is of the view that the continued growth of cryptoasset trading platforms and new
financial products related to cryptoassets has the potential to raise financial stability concerns and increase risks faced by banks, to the extent that the BCBS felt it necessary to set out its prudential expectations regarding banks’ exposures to cryptoassets and related services in jurisdictions where banks are involved in such business activities – including Hong Kong.

In September 2021, the PBoC published a notice that cryptocurrency-related transactions in the PRC are illegal. While this may have caused ripples in the cryptocurrency business in Hong Kong, the city operates under a separate financial and regulatory regime to the PRC system. As detailed in the response to question 10, Hong Kong is currently in the process of introducing a new licensing regime for VASPs and persons carrying out the regulated VA activity.

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