

HONG KONG CRYPTO REGULATION

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SEC STATEMENT ON "FRAMEWORK FOR INVESTMENT CONTRACT ANALYSIS OF DIGITAL ASSETS"

01 | *"reliance on the efforts of others"*

- (a) active participant is responsible for the development, improvement or enhancement, operation or promotion of the network
- (b) essential tasks / responsibilities will be performed / are expected to be performed by an active participant
- (c) active participant supports or creates a market for, or the price of, the virtual asset
- (d) active participant plays a leading or central role in decision making or judgement exercising concerning the network or characteristics or rights of the virtual assets
- (e) purchasers reasonably expect the active participant to undertake efforts to promote its own interests and enhance the value of the network or virtual asset

SEC STATEMENT ON "FRAMEWORK FOR INVESTMENT CONTRACT ANALYSIS OF DIGITAL ASSETS" (CONT.)

02 | "reasonable expectation of profits"

(a) rights to share in the enterprise's income or profit or to realise gain from capital appreciation of the virtual asset

(b) present or future transferability or tradability on a secondary market or platform

(c) purchasers' reasonable expectation that an active participant's efforts will lead to the virtual asset's capital appreciation and the realisation of a return

(d) offered broadly to potential purchasers rather than being targeted at expected users of the goods or services or those with a need for the network's functionality

(e) little correlation between the purchase/offering price and the market price of the goods or services that can be acquired in exchange for the virtual asset

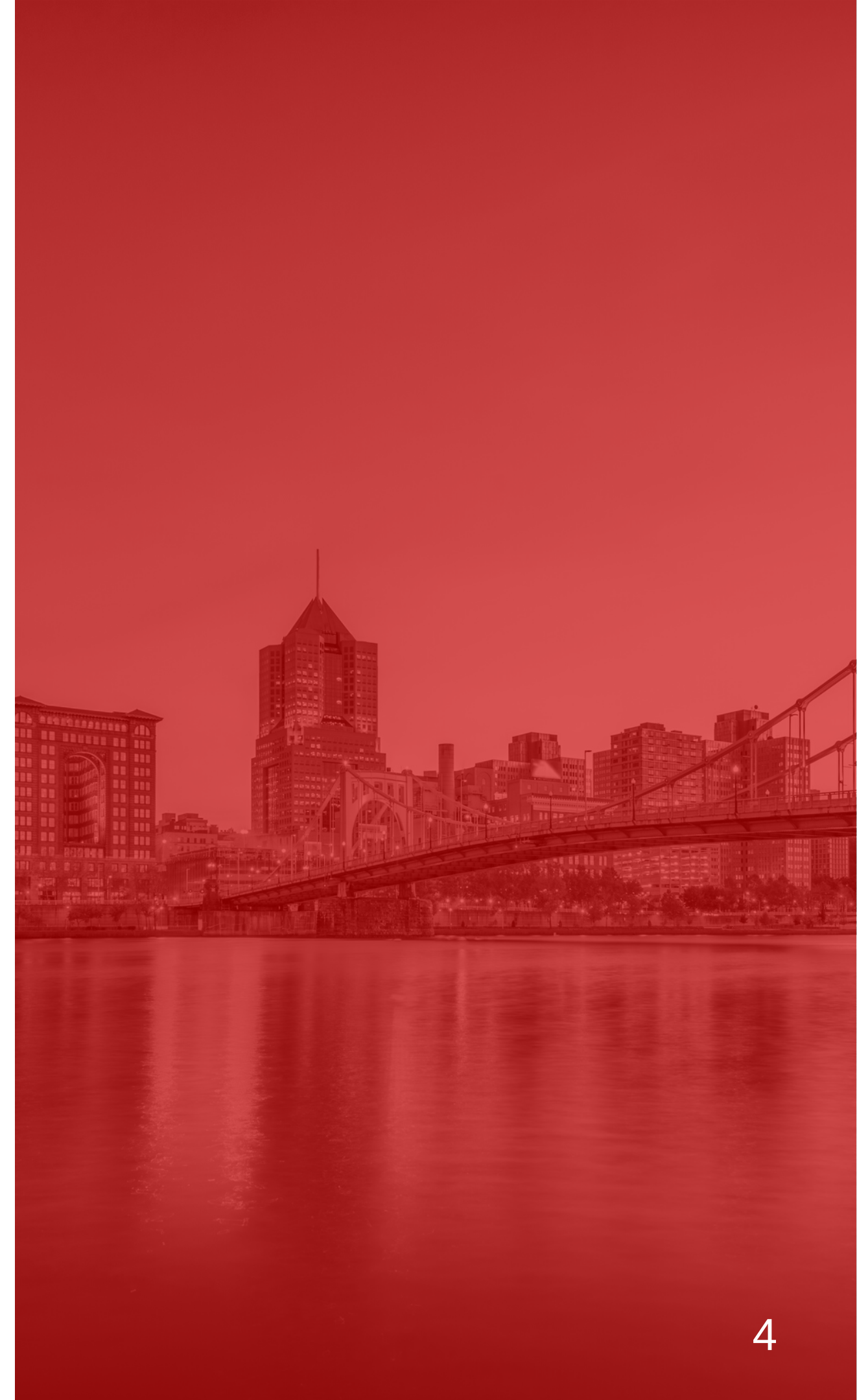
(f) marketed in a way that indicates that the virtual asset is an investment or that the holders will be investors or that the proceeds from the sale of the virtual asset will be used to develop the network or virtual asset

(g) marketed in a way that emphasises the potential appreciation in value of the virtual asset or the potential profitability of the network or the availability of a market for trading the virtual asset, particularly where the active participant promises to create or support a trading market for the virtual asset

SEC STATEMENT ON "FRAMEWORK FOR INVESTMENT CONTRACT ANALYSIS OF DIGITAL ASSETS" (CONT.)

03 | "transaction's economic reality"

- (a) distributed ledger network and virtual asset are fully developed and operational
- (b) virtual asset can be used immediately for its intended functionality on the network
- (c) virtual asset's design meets the needs of users and does not encourage speculation as to its value or the network's development
- (d) ability of a virtual asset to be used to make payments in different contexts or to act as a substitute for real currency
- (e) ability of the virtual asset to be redeemed within a developed network or platform for the goods or services



SEC NO ACTION LETTER

- 1| Funds raised through token sales would not be used to develop the TKJ Platform, Network or App
- 2| Tokens had an immediate use at the time of the token sale
- 3| Token price was fixed at one USD
- 4| Tokens could only be used for air charter services
- 5| Repurchases would only be made at a discount
- 6| Tokens marketed in a manner emphasising their functionality
- 7| Tokens were transferrable only to TKJ wallets and not to wallets outside the network

JOINT STATEMENT ON DIGITAL ASSET ACTIVITIES

- Bank Secrecy Act (BSA) applies to "financial institutions", money service businesses and broker-dealers and mutual funds obliged to register with the SEC
- Where a person falls within the definition of "financial institution" that person's AML/CFT obligations under the BSA will be overseen by the CFTC, FinCEN or the SEC
- Unregulated individuals / entities - must assess whether the digital assets are regulated financial assets and whether the activities would cause them to meet the definition of "financial institution" under the BSA



BITCOIN ETFs

14 JAN 2020

Bitwise withdrew its application with the SEC

30 DEC 2020

VanEck filed an application with the SEC for the VanEck Bitcoin Trust

22 JAN 2021

Valkyrie Digital Assets filed an application with the SEC

The background of the slide is a collage of US dollar bills and a Bitcoin coin. The bills are crumpled and layered, showing various denominations and the 'IN GOD WE TRUST' motto. A large Bitcoin coin is prominently displayed in the center, with the word 'BITCOIN' and 'DECENTRALIZED' visible on its surface. A red rectangular box is overlaid on the center of the image, containing the title and main text.

VIRTUAL ASSET EXCHANGES

FATF R.15

Countries should ensure VASPs are regulated for AML/CFT purposes and licensed or registered and subject to effective systems of monitoring

FATF REPORT ON THE US

(i) most of the convertible virtual currency exchanges, administrators and other similar entities are regulated under the BSA

(ii) regulated entities that engage in transactions denominated in value that substitutes for currency will be subject to the BSA regulations

(iii) money service businesses must register with FinCEN and must be licensed at the state level

FATF REPORT ON THE US (CONT.)

- FATF notes that the US has met most of the new criteria of Recommendation 15 and that the US authorities understand and are aware of the ML/TF risks relating to virtual assets
- FATF considers that the five classes of VASPs were covered under a combination of various pieces of US legislation
- FATF found that the definition of VASP does not explicitly include all VASPs solely incorporated in the US but not performing any activity relating to US persons or having a US nexus



Any person engaging in Virtual Currency Business Activity must obtain a BitLicense

01 | receiving virtual currency for transmission or transmitting virtual currency

02 | storing, holding, or maintaining custody or control of virtual currency on behalf of others

03 | buying and selling virtual currency as a customer business

04 | performing exchange services as a customer business

05 | controlling, administering, or issuing a virtual currency



STATE LEGISLATION

STATE LEGISLATION (CONT.)

"any type of digital unit that is used as a medium of exchange or a form of digitally stored value" and is broadly construed to include units of exchange that:

- i. have a centralised repository or administrator;
- ii. are decentralised and have no centralised repository or administrator; or
- iii. may be created or obtained by computing or manufacturing effort.

This definition specifically excludes digital units that:

- i. are used solely within online gaming platforms
- ii. have no market or application outside of those gaming platforms
- iii. cannot be converted into, or redeemed for, fiat currency or virtual currency
- iv. may or may not be redeemable for real-world goods, services, discounts, or purchases

The following are also excluded:

- digital units as part of prepaid cards; and
- digital units that can be redeemed for goods, services, discounts, or purchases as part of a customer reward program with the issuer but cannot be converted into, or redeemed for, fiat currency or virtual currency

STATE LEGISLATION (CONT.)

STATE LEGISLATION (CONT.)

Licensees are required to satisfy certain compliance requirements:

- minimum capital requirement
- AML/KYC obligations
- entities that hold virtual currencies for third parties must hold them on trust with an approved custodian

Entities holding a Bitlicense may also be required to obtain a NY money transmission licence depending on their activities



REGULATED ENTITIES IN NY STATE

25 regulated entities in the state
of NY as of 19 June 2020, one
of which is Hong Kong-based
XAPO holdings

xapo

CRYPTOCURRENCY ACT 2020

CFTC - primary regulator of crypto-commodities

FinCEN and the Comptroller of the Currency - regulators of cryptocurrencies

SEC - regulator of crypto-securities and "synthetic stable coins"

- FinCEN shall issue rules to require each crypto-currency to allow for the tracing of transactions in the cryptocurrency and persons engaging in such transactions in a manner similar to that required of financial institutions with respect to currency transactions
- FinCEN shall "carry out audits of each reserve-backed stable coin to ensure that each stablecoin is fully backed by currency issued by the US or a foreign government"

STATEMENT ON STABLECOINS

Statement from the US President's Working Group on Financial Markets (23 Dec 2020):

"stablecoin arrangements must comply with applicable US legal, regulatory and oversight requirements" and "providers must meet all applicable AML/CFT obligations before products are brought to market"

UK - CATEGORISATION OF VIRTUAL ASSETS

E-MONEY TOKENS

electronically stored monetary value that represents a claim on the issuer that is issued on receipt of funds for the purpose of making payment transactions and is accepted by another person

firms issuing e-money tokens must be authorised or registered under the Electronic Money Regulations

SECURITY TOKENS

tokens carrying rights and obligations similar to “specified investments” such as shares and debentures under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001

UNREGULATED TOKENS

tokens that are not e-money or security tokens

REGULATED TOKENS

- i. contractual rights and obligations the holder has by virtue of holding or owning the virtual asset
- ii. any contractual right to profit-share, revenues, or other payment or benefit of any kind
- iii. any contractual right to ownership in, or control of, the issuer or other relevant person
- iv. the language used in relevant documentation that suggests the virtual assets are intended to function as an investment
- v. whether the virtual assets are transferable and tradeable on virtual asset exchanges or any other type of exchange or market
- vi. a direct flow of payment from the issuer or other relevant party to holders of virtual assets may be an indicator that the virtual asset is a security.



- **FCA Guidance - utility tokens are "tokens that provide consumers with access to a current or prospective product or service and often grant rights similar to pre-payment vouchers"**

UTILITY TOKENS

SHARES

virtual assets conferring rights similar to shareholders' rights, such as voting rights, access to a dividend or rights to capital distribution on liquidation, are likely to be security tokens

virtual assets representing ownership (through dividends and capital distribution) or control (through voting) are also likely to be security tokens

TRANSFERABLE SECURITIES

- For a token to be considered a transferable security it must be negotiable on the capital markets
- Tokens that confer rights like ownership and control and are capable of being tradeable on the capital markets are likely to be considered transferable securities
- A token which acts like a share but is not a transferable security may still be capable of being a specified investment





DEBT INSTRUMENTS

- A virtual asset which creates or acknowledges a debt owed by the issuer to the virtual asset holder is likely to be considered a debenture and will thus constitute a security token
- If it is negotiable on the capital markets, it may also be a transferable security under MiFID

- Warrants are specified investments that are expressed in terms of the rights they confer in relation to other categories of specified investments
- The rights conferred must be rights to 'subscribe' for the relevant investments
- If virtual assets are issued that give holders the right to subscribe for specified investments, the virtual assets will likely constitute warrants and will therefore be security tokens

WARRANTS

CERTIFICATES REPRESENTING CERTAIN SECURITIES

- A certificate or other instrument that confers contractual or property rights over other investments will be a specified investment if the other investment is owned by someone who is not the person on whom the certificate confers rights; and that other person's consent is not required for the transfer of the investments
- A virtual asset which confers rights in relation to tokenised shares or debentures, including depositary receipts, is likely to be a security token



- CIS - an arrangement, the purpose or effect of which is to enable persons taking part in the arrangement to participate in, or receive profits or income arising from the investment, or sums paid out of such profits or income
- Participants do not have day-to-day control over the management of the investment and the participants' contributions, and the profits from which payments are made, are pooled and/or the investment is managed as a whole by or on behalf of the scheme's operator
- A virtual asset that acts as a vehicle through which profits or income are shared or pooled, or where the investment is managed as a whole by a market participant is likely to be a collective investment scheme

UNITS IN A CIS

RIGHTS AND INTERESTS IN INVESTMENTS

- Rights to or interests in certain investments also constitute specified investments under the RAO
- Virtual assets that represent rights to or interests in other specified investments are therefore also likely to be securities



PRODUCTS REFERENCING VIRTUAL ASSETS

- Products that reference virtual assets are also likely to be Specified Investments as options, futures or contracts for difference under the RAO
- They may also constitute financial instruments

UK APPROACH TO RETAIL TRADING

OCT 2020

FCA published final rules banning the sale of crypto derivatives to retail investors (PS20/10)

JUL 2019

consultation on rules to address harm to retail consumers from the sale of derivatives and exchange traded notes (ETNs) referencing certain types of crypto assets

JAN 2021

ban came into effect

A hand holds a physical Bitcoin coin in the foreground. The coin features the Bitcoin symbol and the text 'BITCOIN' and 'DECENTRALIZED'. In the background, a laptop screen displays a blurred image of a person's face. The entire image is overlaid with a semi-transparent red filter.

MCQs

QUESTION 1

In relation to the Howey Test, which of the following characteristics would NOT give rise to a reasonable expectation of profits?

A. Future transferability or tradability on a secondary market.

B. Holders will have rights to share in the enterprise's income or profit.



C. The digital asset is offered to a targeted group of expected users of the goods or services.

D. The purchasers reasonably expected an active participant's efforts will lead to the virtual asset's capital appreciation and realisation of a return.





QUESTION 2


A landmark decision of the SEC was the determination that Turnkey Jet's tokens issued during its ICO were not securities. Which of the following was NOT a reason given by the SEC in reaching this conclusion?



- A. The tokens only had a future use.
- B. The funds raised would not be used to develop Turnkey's platform, network or app, which would be fully developed at the time of the ICO.
- C. The tokens would not be transferable to external wallets.
- D. The token price was fixed at one USD.

QUESTION 3

Which of the following activities would NOT require a BitLicense (assuming that in all cases, the activities are being conducted in New York State)?

- A. Performing exchange services as a customer business.
- B. Receiving virtual currency for transmission or transmitting virtual currency.
- C. Buying and selling virtual currency as a customer business.
-  D. A merchant that uses virtual currency solely for the purchase / sale of goods or services.

QUESTION 4

A token, described as a “pure utility token” in its whitepaper, which offers access to a future product and allows the holder to share in future profits, would most likely be considered by the UK’s FCA to be a -

A. E-money token.

B. Utility token.



C. Security token.

D. Exchange token.

QUESTION 5

Which of the following would the FCA most likely consider to be an unregulated token?



A. A token which allows the holder to share in the company's profits, provides the holder with voting rights and can be transferred and traded on crypto exchanges.

B. A token that is used as a rewards mechanism for customers, which is non-transferable and not redeemable for a cash equivalent. No other financial rights are offered.

C. A token issued by Firm A that references a share in firm B. It is non-transferable and cannot be traded in the capital markets.

D. A token issued by a platform which allows users to exchange fiat funds for tokens. The tokens confer a right of ownership of the platform on the holder proportionate to the number of tokens held and a right to share in the profits.

The background of the slide is a solid red color with a complex, abstract pattern of thin, white, wavy lines. These lines are scattered across the entire surface, creating a textured, almost organic feel. The lines vary in thickness and direction, some appearing as small loops or spirals, while others are more linear and elongated.

Q&A