

HONG KONG CRYPTO REGULATION

Webinar 6 - 19 February 2021

FCA GUIDANCE ON EXCHANGE TOKENS

- Exchange tokens are not currently viewed as legal tender in the UK and are not considered to be a "currency" or "money"
- Exchange tokens do not grant the holder any rights associated with Specified Investments
- The fact that an exchange token can be acquired and held for speculative purposes rather than exchange, with holders expecting the tokens to increase in value, is not sufficient to bring the exchange token within the definition of a Specified Investment



AML/CFT REGULATION OF CRYPTO ACTIVITY IN THE UK

- Amendments to the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 extended AML/CFT regulation to cryptoasset exchange providers (CEPs) and custodian wallet providers (CWPs) which carry on business in the UK (from 10 January 2020)
- CEPs and CWPs are now included in the definition of "relevant persons"
- CEPs and CWPs must register for AML supervision with the FCA

DEFINITION OF "CRYPTOASSET EXCHANGE PROVIDER"

a firm or sole practitioner who by way of business provides one or more of the following services, including where the firm or sole practitioner does so as creator or issuer of any of the cryptoassets involved, when providing such services -

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

DEFINITION OF "CUSTODIAN WALLET PROVIDER"

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

DEFINITION OF "CRYPTOASSET"

a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can be transferred, stored or traded electronically. The definition includes a right to, or interest in, the cryptoasset

UTILITY TOKENS

"virtual assets that provide consumers with access to a current or prospective service and often grant rights similar to pre-payment vouchers. In some instances, they might have similarities with, or be the same as, rewards-based crowdfunding."

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

USE OF VIRTUAL ASSETS TO FACILITATE REGULATED PAYMENT SYSTEMS

Regulation under the Payment Services Regulations (PSRs):

- PSRs apply to "funds" which are defined as *"banknotes and coins, scriptural money and electronic money"*
- Virtual assets can constitute e-money in certain circumstances and the provision of payment services in virtual assets which qualify as e-money would then be regulated under the PSRs
- The use of cryptocurrency as an intermediary currency in money remittance may also involve providing a payment service regulated under the Payment Service Regulations

E-MONEY

- E-money issuance is regulated under the Electronic Money Regulations 2011 (EMRs) and is a regulated activity under article 9B of the Regulated Activities Order when carried out by credit institutions, credit unions and municipal banks
- "E-money" is defined as *electronically stored monetary value as represented by a claim on the electronic money issuer which is:*
 - i. issued on receipt of funds for the purpose of making payment transactions;*
 - ii. accepted by a person other than the electronic money issuer; and*
 - iii. not excluded by regulation 3 of the EMRs.*



- HM Treasury has proposed introducing a new category of regulated tokens - "stable tokens"
- Proposed definition of "stable tokens" will cover stable coins used as a means of payment backed by single fiat currency and stable coins where the value is linked to an asset other than a single fiat currency
- Where e-money tokens are also stable tokens, they may be subject to enhanced requirements under the new regime if they have "significant potential" to become systemic

STABLECOINS

AUSTRALIA - ICOs

- 30 May 2019 - ASIC updated its information on ICOs and virtual assets set out in INFO 225
- *when the virtual asset issued in an ICO is a financial product* - issuer must consider and comply with the relevant capital raising provisions of the Corporations Act, Australian financial services licensing requirements and other regulatory requirements
- *where the virtual asset issued in an ICO is a non-financial product* - entities are expected to comply with relevant laws and obligations



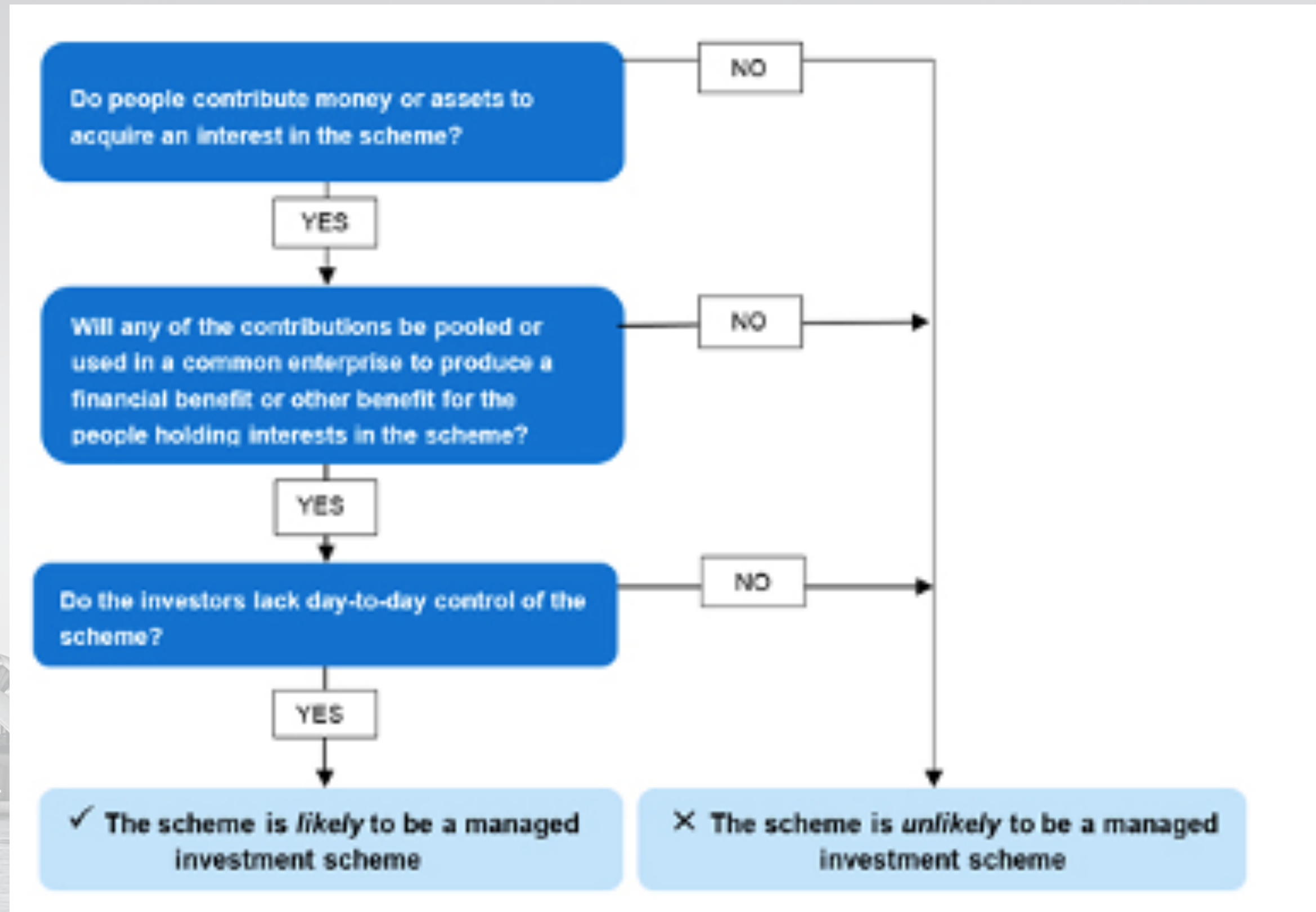
ICOs constituting or involving a financial product

- Undertake assessment of the rights attached to the virtual assets - normally set out in the whitepaper and/or can be determined from other circumstances
- whether an ICO constitutes or involves a financial product or not, the Australian Consumer Law applies and so the prohibitions against misleading or deceptive conduct must be adhered to



ICOs (cont.)

MANAGED INVESTMENT SCHEMES (MIS)



AN ICO AS AN OFFER OF A SECURITY

- An ICO may be considered an offer of a security where an ICO is created to fund a company (or fund an undertaking that looks like a company)
- In this case, the prospectus requirements would apply as they do to IPOs

NON-CASH PAYMENT FACILITIES (NCPs)

"an arrangement through which a person makes payments, or causes payments to be made, other than by the physical delivery of currency"

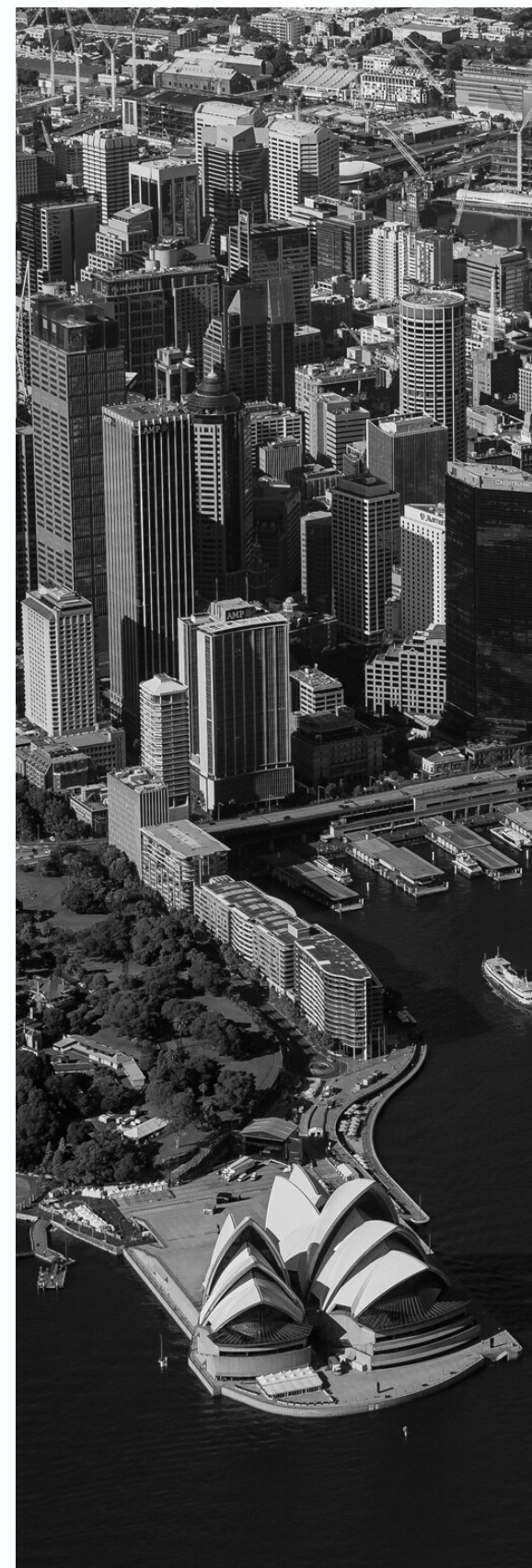
An ICO may involve a NCP facility if it includes an arrangement that allows: payments to be made in a form of value (instead of physical currency) to a number of payees; or payments to be started in a form of value (not a physical currency) and later converted to fiat currency to enable completion of the payment

FINANCIAL MARKET OPERATION

Any platform that enables consumers to buy, be issued with, or sell virtual assets that are financial products may involve the operation of a financial market and the operator must hold an Australian market licence, unless covered by an exemption.

FINANCIAL PRODUCTS THAT REFERENCE VIRTUAL ASSETS

Entities proposing to issue financial products that are linked to, or reference, virtual assets; invest in virtual assets; or otherwise enable consumers to have exposure to virtual assets may require a new AFS licence or licence variation.



AML/CFT

- AML/CFT Act 2006 - registered exchanges are required to comply with anti-money laundering and counter-terrorist financing obligations
- Digital currency exchange service - involves converting crypto assets for fiat currency or fiat currency for crypto assets
- Where a digital currency exchange service is provided as a business, the exchange must be registered as a digital currency exchange with AUSTRAC unless an exemption applies



MALTA



NOV 2018

VFA Act came into effect

FEB 2020

MFSA issued statement in relation to Binance

SEP 2020

Bluetrade and BeQuant announced plans to set up operations in Malta

NOV/DEC 2020

Crypto.com received in-principle approval for a Class 3 VFA licence; CoinDeal obtained in-principle approval for a Class 4 VFA licence

VFA ACT

Virtual financial assets - any form of digital medium of recordation used as a digital medium of exchange, unit of account or store of value that is not a financial instrument, a virtual token or electronic money.

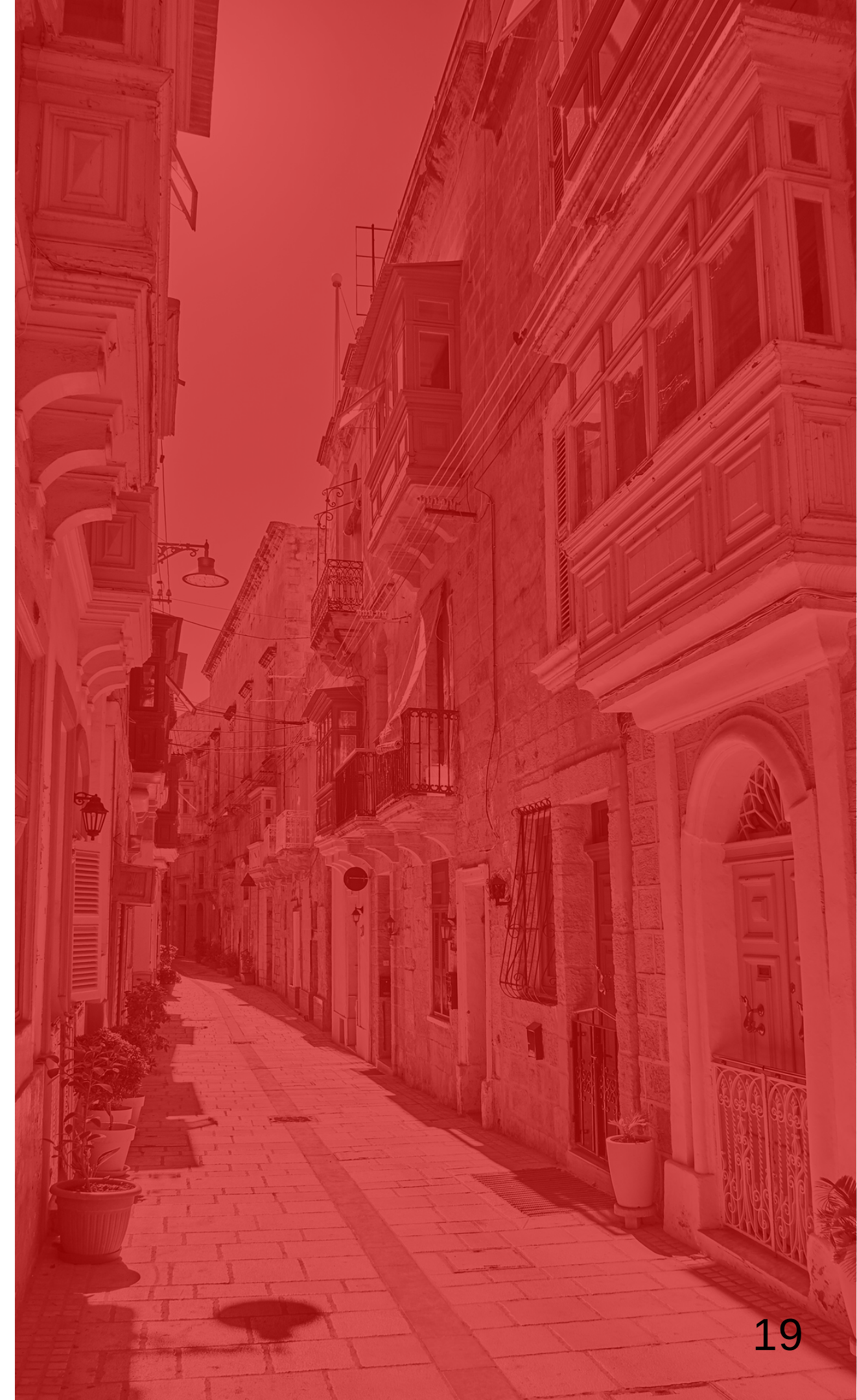
Financial Instrument - defined under the MiFID and the Investment Services Act and activities related to financial instruments are regulated under the Investment Services Act

Virtual Token - a token whose utility, value or application is restricted solely to the acquisition of goods or services, either solely within the DLT platform on or in relation to which it was issued or within a limited network of DLT platforms

Electronic Money - to qualify as electronic money, a DLT asset must be issued at par value on receipt of funds by the issuer and be redeemable at any time only by the issuer. It should be used for making payments and must be accepted by a person other than the issuer as a means of payment

WHITEPAPER CONTENT REQUIREMENTS

- Issuers licensed or registered by the MFSA are required to issue a whitepaper which meets the requirements of the VFA Act
- Requirement applies to any entity which proposes to
 - (i) offer a virtual financial asset to the public in or from Malta; or
 - (ii) apply to trade a virtual financial asset on a DLT exchange



The background of the slide is a black and white photograph of a coastal city. On the left, there are multi-story buildings with balconies and windows, situated on a hillside. A stone wall runs along the base of the buildings. In the foreground, there are rooftops with satellite dishes and other structures. On the right, the sea is visible, with a bright reflection of the sun on the water's surface. The sky is clear and bright. A large red rectangular overlay covers the center of the image, containing the title and list.

ISSUER OBLIGATIONS

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

VFA AGENT REQUIREMENTS

- The ICO issuer must appoint a VFA agent approved by the MFSA on an ongoing basis
- VFA agent is responsible for advising and guiding the issuer as to its responsibilities and obligations under the VFA Act and related rules and regulations
- VFA agent acts as a point of liaison between the issuer and the MFSA and must submit all required documentation
- VFA agent must disclose any material information relating to regulatory non-compliance to the MFSA



REQUIREMENTS FOR ADVERTISEMENTS

- Must be clearly identifiable as such and the information it contains must be accurate and not misleading and must be consistent with the information contained (or to be contained) in the white paper
- Must contain a statement that a white paper has been or will be issued and give the addresses and times at which copies are or will be available to the public
- Advertisements related to a VFA service can only be issued by a VFA licence holder or by another person where the licence holder's board of administration has vetted and approved its contents

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- 1 | Portfolio management
 - 2 | Custodian or nominee services
 - 3 | Providing investment advice in relation to virtual financial assets
 - 4 | Placing virtual financial assets
 - 5 | Operating a VFA exchange
 - 6 | Reception and transmission of orders relating to virtual financial assets
 - 7 | Execution of orders
 - 8 | Dealing on own account

VFA SERVICE PROVIDERS

The grant of a licence requires the MFSA to be satisfied on an on going basis that:

(1) The applicant (and its beneficial owner, qualifying holder, members of the board of administration or any other person who directs the business of the applicant) is fit and proper to provide the relevant VFA services and complies and observes the requirements of the VFA Act and other relevant regulations and rules;

(2) If the applicant is a natural person, that such person is a resident of Malta;

(3) If the applicant is a legal person, that it is either constituted in Malta or in accordance with Malta's laws or in a recognised jurisdiction and has established a branch in Malta;

(4) Its actual activities are compatible and related to VFA services.

APPLICATION FOR THE LICENCE



- The applicant does not have sound and prudent management, robust administration arrangements and adequate internal control or security mechanisms;
- The applicant has close links to a person or persons that prevent it from exercising effective supervision of the applicant; or
- Granting a licence to the applicant could pose a risk to investors, the general public, Malta's reputation, and promotion of innovation or competition.

GROUND'S FOR REFUSAL



SUSPENSION / CANCELLATION OF LICENCE

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

LICENCE HOLDERS' CONDUCT AND OBLIGATIONS

- Must act honestly, fairly and professionally
- Must comply with the requirements of the VFA Act and any related rules and regulations
- Owe fiduciary duties towards their customers
- Must maintain systems and security access protocols to appropriately high standards

PREVENTION OF MARKET ABUSE

INSIDER DEALING

Where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, virtual financial assets to which that information relates OR;

Recommendations / inducements, where the person is aware that it is based on inside information

UNLAWFUL DISCLOSURE OF INSIDE INFORMATION

A person possesses inside information and discloses that information to any other person, except where the disclosure is permitted by the VFA Act and regulations or rules issued under it

MARKET MANIPULATION

Manipulation or attempted manipulation of a virtual financial asset or a benchmark through the use of an abusive strategy

LICENCE HOLDERS' AUDITOR

- The auditor has a duty to report certain facts and decisions to the MFSA and simultaneously communicate the information to the board of administration of the licence holder
- The auditor is required to report to the MFSA annually on the systems and security protocols of the licence holder
- It is an offence for a person to induce or attempt to induce another person to enter into a VFA agreement by knowingly making statements that are misleading, false or deceptive
- VFA Act also imposes reporting obligations with respect to suspected ML/TF activity

