



ICO regulation in Hong Kong

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10 April 2018

RPC – about us



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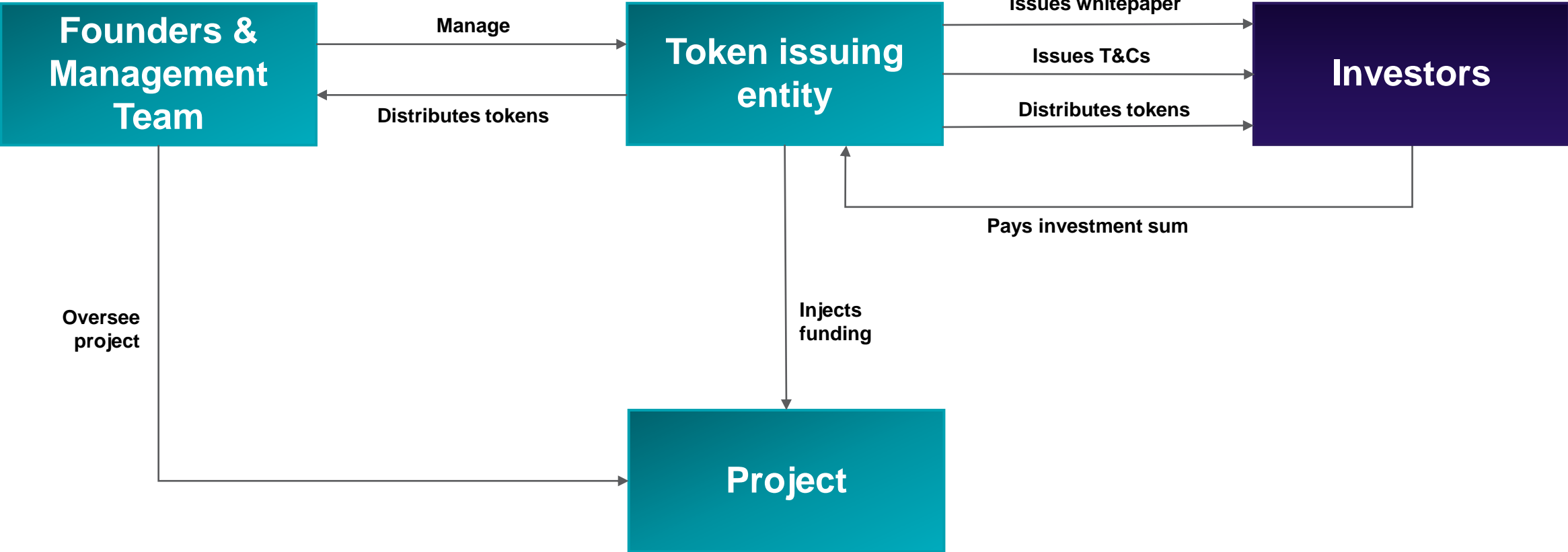
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Outline

- How a token sale/ICO works
- ICO vs. other forms of crowdfunding
- Regulatory trends around the world
- Regulatory landscape in Hong Kong
- Looking ahead
- Q&A

Common ICO structure



ICO vs. IPO

- **Startups vs. Credible companies with track record**
- **IPO Regulatory framework**
 - Regulatory authority involvement
 - Strict procedural requirements
 - High threshold company requirements
 - High level of transparency to potential investors

ICO vs. Crowdfunding

- ICO = hybrid between IPOs and crowdfunding?
- Regulatory treatment for crowdfunding generally positive
- Different regulatory attitude towards ICOs and crowdfunding?

Types of ICO tokens

1. **Cryptocurrencies**
2. **Security Tokens**
3. **Utility Tokens**

Security Tokens

The Howey Test

A transaction will be considered a security if all of the following requirements are met:

- 1. It is an investment of money*
- 2. There is an expectation of profits from the investment*
- 3. The investment of money is in a common enterprise*
- 4. Any profit comes from the efforts of a promoter or third party*

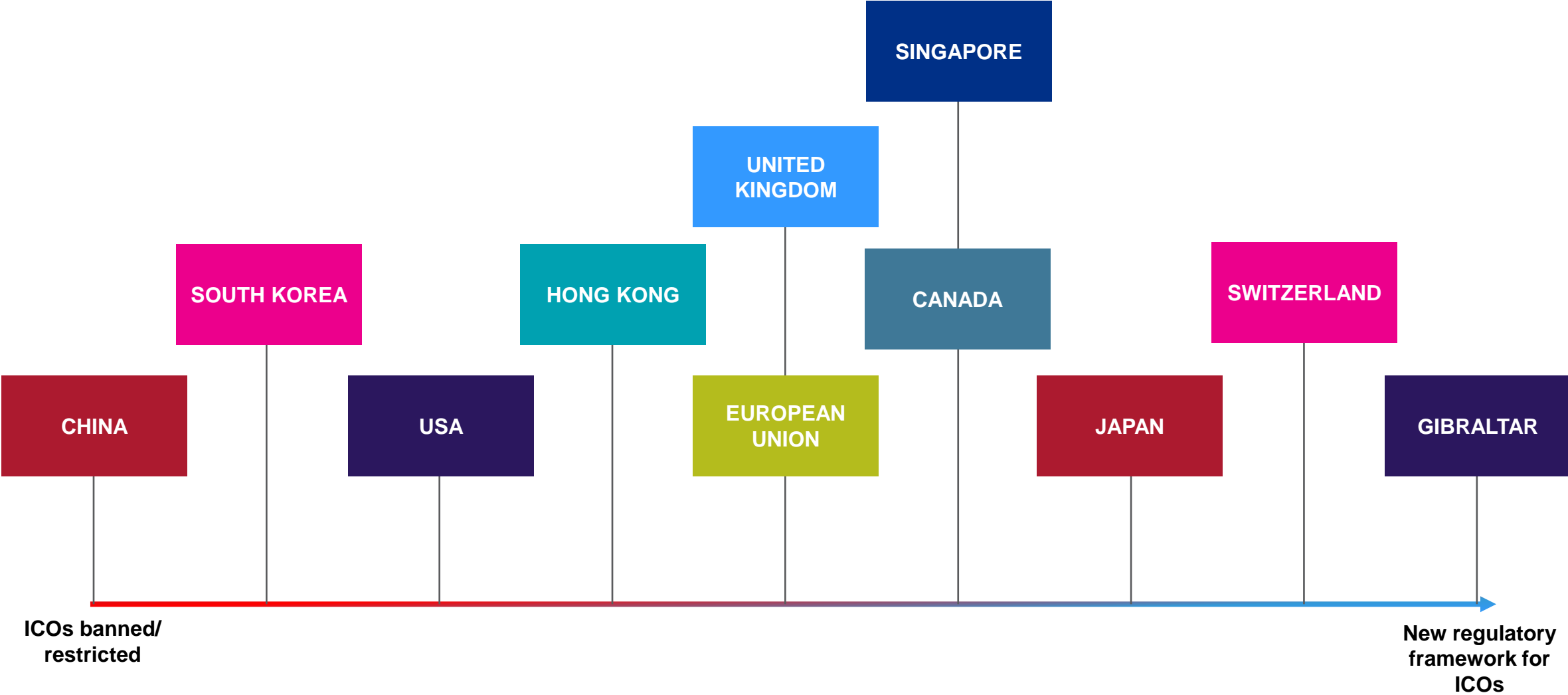
Utility Tokens

- **SEC has not given official guidance on utility tokens**
- **ICOs hoping to avoid regulatory hurdles often emphasize the utility of the token BUT the Howey Test remain the “go to” test**
- **Utility token holders often have rights to:**
 - **program, develop or create features for the distributed ledger**
 - **contribute labour or effort to the system**
 - **use the services of a system and its outputs at no charge**
 - **sell the products of the system.**

ICO - Regulatory trends

- Regulatory bodies waking up to the need to regulate ICOs
 - Spotlight on unlisted securities and the abundance of “bad” ICOs
 - Legal treatment of tokens remains unclear in many jurisdictions
 - Regulatory bodies experimenting with ways to deal with the new phenomenon
- Smaller economies emerging as crypto-friendly hubs?

ICO – Spectrum of regulations



Regulatory landscape in Hong Kong

SFC Notice dated 5 September 2017

- Depending on the facts and circumstances of an ICO, digital tokens that are offered or sold may be securities as defined in the SFO
 - Where digital tokens offered in an ICO represent equity or ownership interests in a corporation, these tokens may be regarded as **shares**
 - 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**
 - If token proceedings 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, they may be regarded as an **interest in a collective investment scheme**
- Caution against fraud, money laundering and terrorist financing risks

Regulatory landscape in Hong Kong

SFC Notice dated 9 February 2018

- Investors are warned about the potential risks of investing in ICOs
- Several complaints from investors against ICO issuers alleged unlicensed or fraudulent activities.
- SFC will continue to closely monitor ICOs, and will not tolerate any violations of Hong Kong securities laws

Regulatory landscape in Hong Kong

Regulatory landscape constantly changing

- SFO definition of “security” – the “Howey” test
 - Major difference between treatment of “securities offering” and “non-securities offering”
- SFO definition of “collective investment scheme”
- Anti-fraud requirements?

Regulatory landscape in Hong Kong

Case Study: *Black Cell Technology Limited*

Facts

- Black Cell is a HK based startup developing a mobile-based food marketplace
- ICO proceeds would be used to fund the development of a mobile application
- Contributors of the ICO would have be eligible to redeem equity shares in the company

Question to be asked

- Is it a “collective investment scheme” that would require the regulator’s approval to sell or market to the general public in Hong Kong?

Regulatory landscape in Hong Kong

Case Study: *Black Cell Technology Limited*

Elements of a “collective investment scheme”

1. it must involve an arrangement in respect of property;
2. participants do not have day-to-day control over the management of the property even if they have the right to be consulted or to give directions about the management of the property;
3. the property is managed as a whole by or on behalf of the person operating the arrangements, and/or the contributions of the participants and the profits or income from which payments are made to them are pooled; and
4. the purpose of the arrangement is for participants to participate in or receive profits, income or other returns from the acquisition or management of the property.

Regulatory landscape in Hong Kong

Case Study: *Black Cell Technology Limited*

SFC Stance

- SFC determined that Black Cell's ICO would be considered a "collective investment scheme"
 - Black Cell was likely targeted because of the promise that token holders would get equity shares
- Black Cell agreed to provide refunds for HK investors. Black Cell has also undertaken not to devise, set up or market any scheme that constitutes a Collective Investment Scheme (CIS) unless in compliance with the relevant requirements

Regulatory landscape in Hong Kong

Case Study: *Black Cell Technology Limited*

Implication

- This is the first time that the regulatory authority has publicly named a company that it has taken action against. It shows that the SFC is keen to proactively take robust positions against questionable transactions
- This ICO also depicts the challenges regulators face due to the global nature of fundraising
 - the SFC action follows a cease-and-desist order issued by the Securities and Exchange Commission of the Philippines in January
 - in other words, even if an ICO is shut down in one jurisdiction, the ICO will simply shift its focus to another.

ICO outlook - Hong Kong

- In light of ICO ban in the PRC, Hong Kong is becoming an increasingly important jurisdiction for ICOs in Asia
- ICO regulations to pick up pace in 2018 (no sign of imminent ban on ICOs)
- More statements for ICOs expected from the SFC
- Clear frameworks expected for monitoring the ICO ecosystem
- More enforcement cases against questionable ICO transactions

ICO regulations – is it welcomed?

Even though “regulation” may be the opposite of what crypto is all about ...

- Proper regulations can
 - bring cryptocurrencies into mainstream markets
 - deter “bad” ICOs
 - give ICOs a sense of legitimacy
 - improve investor confidence

Q&A

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