



COMMENTARY
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Hong Kong Cracks Down on Digital Tokens and Cryptocurrency Exchanges

IN SHORT

The Situation: Surging interest in digital tokens has caught the attention of regulators in Hong Kong.

The Development: Hong Kong's Securities and Futures Commission recently introduced additional regulatory measures, and seven digital token / cryptocurrency exchanges are under investigation for potential unlicensed trading in "securities."

Looking Ahead: Would-be buyers of digital tokens should review a number of considerations, some of which are enumerated here, before completing a purchase.

With the surging popularity of digital tokens, investments today are no longer limited to shares, bonds, and fixed deposits.

In its purest form, a digital token is a piece of computer code used to represent a particular asset; it allows a person to access certain goods and services from its issuer in the virtual world. In some ways, it is not unlike a coupon issued by a department store in the physical world; that coupon allows a customer to obtain certain goods and services (e.g., a price discount) from that department store. However, the same technologies can be used to create digital currencies ("cryptocurrencies"), where encryption and blockchain techniques can be used to generate units of currency and verify their transfer, operating independently of a central bank. Bitcoin is probably the best-known example of a cryptocurrency, but it is by no means the only one.

Increasingly, both start-ups and established companies have sought to raise funds by offering digital tokens to investors. What has become clear is that, even where a company offers a true "utility" digital token, it is possible for that token to appreciate in value afterwards. If the token is capable of being traded, and investors are able to realize value from holding the token for even a short time, there is a risk that under individual national regulatory regimes, the token will be considered as a regulated investment.

According to the website ICOdata, digital token offerings have raised more than US\$ 5 billion in 2017 alone. In terms of daily trading volume, reports indicate that a number of cryptocurrency exchanges connected to Hong Kong rank in the top 20 globally.



The SFC has repeatedly warned investors of the risks of investing in ICOs and cryptocurrencies.



This trend has alerted Hong Kong's financial and securities regulators.

In Hong Kong, the Securities and Futures Commission ("SFC") previously issued statements on September 5, 2017, and December 11, 2017, warning of the potential risks of investing in digital tokens, and stressing that such tokens could constitute "securities" regulated under the Securities and Futures Ordinance ("SFO"). See Jones Day's [September 2017 Commentary: Announcement Clarifies Regulatory Position on Initial Coin Offerings in Hong Kong](#).

On February 9, 2018, the SFC announced the taking of further regulatory measures. Seven digital token / cryptocurrency exchanges were put under investigation for potential unlicensed trading in "securities" under the SFO. The exchanges, which were not publicly identified, are said to have either confirmed that they did not knowingly trade in securities, or to have taken "immediate rectification measures" such as blocking access to Hong Kong residents.

In its latest announcement on March 19, 2018, the SFC announced that it had taken regulatory action against a company called Black Cell Technology Limited ("Black Cell"). Black Cell had advertised its KROPS digital tokens on its website with the pitch that the proceeds would be used to fund the development of a mobile app. The website was generally accessible by members of the Hong Kong public. Following the SFC's investigations, Black Cell agreed to halt the sale of KROPS tokens and unwind all transactions with Hong Kong customers over concerns it had engaged in unauthorized promotional activities and unlicensed regulated activities, and placed the following pop-up message on its website: "The following token sale is not open for American citizens (and/or U.S. residents), Hong Kong citizens and any citizen or resident of a country that does not allow participation."

Apart from KROPS digital tokens, the SFC is also scrutinizing the issuers of other digital tokens, many of whom could fall under the SFC's jurisdiction on the basis of having offered or dealt in securities without complying with the provisions of the SFO and the Companies (Winding Up and Miscellaneous Provisions) Ordinance. There are harsh penalties for non-compliance. For instance, a person convicted of unlicensed securities dealing can be liable to a fine of up to HK\$5,000,000 and to imprisonment for up to seven years.

The SFC has repeatedly warned investors of the risks of investing in digital tokens and cryptocurrencies. Unlike shares (which give investors rights of a shareholder) and debentures (which give investors rights to principal and interest), digital tokens issued for fundraising purposes may not offer any substantive rights to investors. Furthermore, digital token issuers often do not have a proven financial track record to deliver on their promises of return on investment.

Points to Consider Before Purchasing a Digital Token

1. What is being offered – a "utility token", an investment token, or a combination of both?
2. Does the offering comply with local laws and regulations?
3. What is the purpose of the offering? In particular, what will the issuer use the funds for?
4. Is the token legally traded on an exchange?
5. Is the exchange operating in accordance with local laws?
6. Is the trading of the token transparent?
7. How secure is the token? Is it exposed to hacking risks?

THREE KEY TAKEAWAYS

1. Interest in digital currencies is surging, as evidenced by token offerings in 2017 raising more than US\$ 5 billion.
2. There is risk that under individual national regulatory regimes, a digital token will be considered as either a regulated investment, a security, or even a cryptocurrency.
3. The regulation of digital tokens is increasing, and the SFC has indicated it will not tolerate violations of Hong Kong's securities laws.

CONTACTS

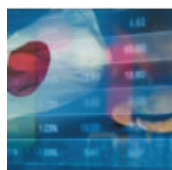


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