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HSF virtual CPD week

Virtual asset regulation in Hong Kong and recent cryptocurrency disputes

12 October 2022

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1

Overview of the Hong Kong regulatory framework

Virtual assets

FATF definition: “A virtual asset is a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes.”



Bitcoin and other
cryptocurrencies



Security tokens



Utility tokens



Non-fungible
tokens (NFTs)



Stablecoins



Central bank
digital currencies

Risk-based approach to regulation

Same risk, same regulation.

“This means that authorities should focus on the functions performed and risks posed by an activity, and apply the appropriate regulatory framework in the same manner as they would apply it to entities performing the same functions or activities, and posing the same risks.”

Eddie Yue
Chief Executive
Hong Kong Monetary Authority
12 January 2022

Recent guidance

SFC issued a [statement](#) on regulatory framework for virtual asset portfolios managers, fund distributors and trading platform operators

FSTB launched a [public consultation](#) to introduce a licensing regime for virtual asset service providers (VASP) regime

FSTB published [consultation conclusions](#) on the VASP licensing regime

HKMA issued a [discussion paper](#) on cryptoassets and stablecoins

HKMA issued a [circular](#) to banks on regulatory approaches to banks' interface with virtual asset and VASPs

Gazettal of [Anti-Money Laundering and Counter-Terrorist Financing \(Amendment\) Bill 2022](#)

SFC's [position paper](#) on regulation of virtual asset trading platforms – opt-in regime

SFC [granted its first virtual asset trading platform licence](#) under the opt-in regime

The IA issued a [circular](#) to insurers on regulatory approaches of the IA in relation to virtual asset and VASPs

SFC issued a [reminder](#) to investors on risks associated with NFTs

HKMA and the SFC issued a [joint circular](#) to banks and SFC-licensed intermediaries on intermediaries' virtual asset-related activities

2018

2019

2020

2021

2022

Regulatory framework for the virtual asset industry

Regulated activity	Scope of supervision	Licensing requirement
Virtual asset trading platform (VATP)	<ul style="list-style-type: none"> Centralised virtual asset trading platforms which offer trading in at least one virtual asset that is a security 	<ul style="list-style-type: none"> 'Opt-in' Type 1 (dealing in securities) and Type 7 (automated trading services) licence Comply with terms and conditions for VATP operators
Virtual asset portfolio management (VAPM)	<ul style="list-style-type: none"> Intermediaries that manage portfolios that invest in securities and/or futures contracts, and portfolios that invest solely or partially (subject to the <i>de minimis</i> requirement) in virtual assets that do not constitute securities or futures 	<ul style="list-style-type: none"> Type 9 (asset management) licence for managing portfolios of securities and/or futures Proforma Terms and Conditions that subject the VAPM to SFC oversight in respect of the management of portfolios that invest in virtual assets
Virtual asset fund distribution	<ul style="list-style-type: none"> Intermediaries that distribute funds that invest (solely or partially) in virtual assets 	<ul style="list-style-type: none"> Type 1 (dealing in securities) licence
Distribution of virtual asset-related products	<ul style="list-style-type: none"> Intermediaries that distribute "virtual asset-related products" (i.e. investment products which: (a) have a principal investment objective or strategy to invest in virtual assets; (b) derive their value principally from the value and characteristics of virtual assets; or (c) track or replicate the investment results or returns which closely match or correspond to virtual assets) 	<ul style="list-style-type: none"> Type 1 (dealing in securities) licence Type 2 (dealing in futures contracts) licence Licensing condition uplift
Virtual asset dealing services	<ul style="list-style-type: none"> Intermediaries that provide virtual asset dealing services under omnibus or introducing model 	<ul style="list-style-type: none"> Type 1 (dealing in securities) Type 2 (dealing in futures contracts) Licensing condition uplift (omnibus model)
Virtual asset advisory services	<ul style="list-style-type: none"> Intermediaries that advise on virtual asset-related products 	<ul style="list-style-type: none"> Type 4 (advising on securities) Type 5 (advising on futures contracts) Licensing condition uplift
Virtual asset service provider (VASP)	<ul style="list-style-type: none"> Operator of a virtual asset exchange 	<ul style="list-style-type: none"> VASP licence issued under the AMLO (effective 1 March 2023)

SFC and HKMA joint circular on virtual asset-related activities

Distribution of virtual asset-related products

- Selling restrictions
- Virtual asset-knowledge test, suitability obligations, conduct due diligence on products, warning statements

Provision of virtual asset dealing services

- Partner with SFC-licensed virtual asset trading platforms for the provision of virtual asset dealing services
- Virtual asset dealing services should only be provided to existing clients to which intermediaries provide Type 1 RA services
- Conduct requirements for provision of virtual asset dealing services under an omnibus arrangement
- Intermediaries wishing to provide virtual asset discretionary account management services will need to satisfy the additional requirements set out in the Proforma Terms and Conditions for Licensed Corporations that manage portfolios that invest in virtual assets

Provision of virtual asset advisory services

- Observe suitability obligations
- Offer services to professional investors
- Virtual-asset knowledge test

HKMA regulatory approach to authorised institution's (AI) interface with virtual assets and VASPs



- Risk-based approach to supervising AI's virtual asset activities

- Currently no prohibitions from incurring financial exposures to virtual assets on the premise that AIs have put in place adequate risk-management controls, with sufficient senior management oversight

- AIs should establish and implement effective AML/CFT policies, procedures and controls to manage and mitigate ML/TF risks. Particularly, in relation to:
 - AI's customers engaging in virtual asset-related activities through their bank accounts
 - banking relationship with VASPs

- Virtual asset-related products are very likely to be considered complex products
- Some virtual asset-related products may be subject to various selling restrictions in or outside of Hong Kong

AIs intending to engage in virtual asset activities should discuss with the HKMA (and other regulators where appropriate) and obtain the HKMA's feedback

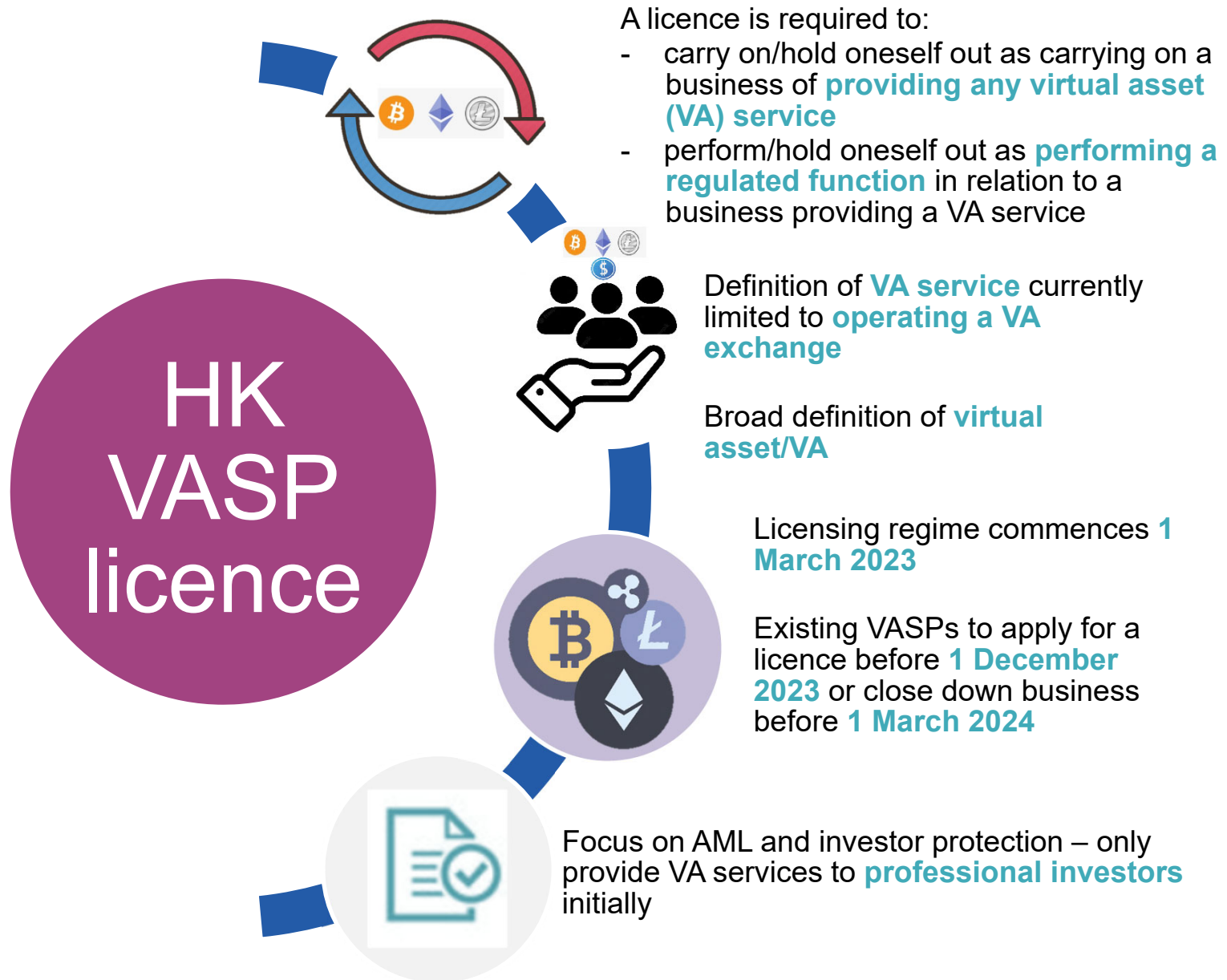


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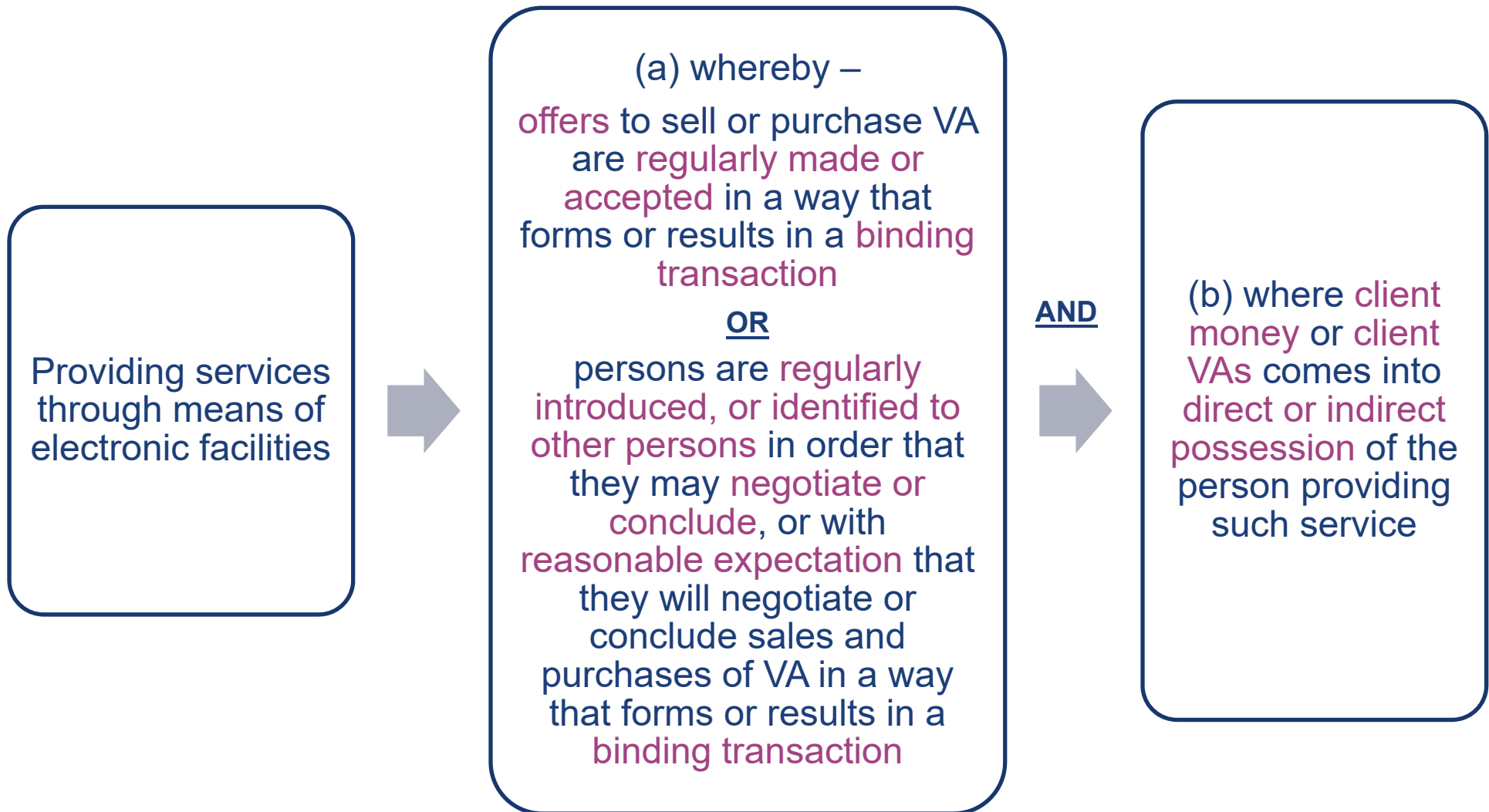
VASP licensing regime

Scope of VASP licensing regime



Definition of VA service

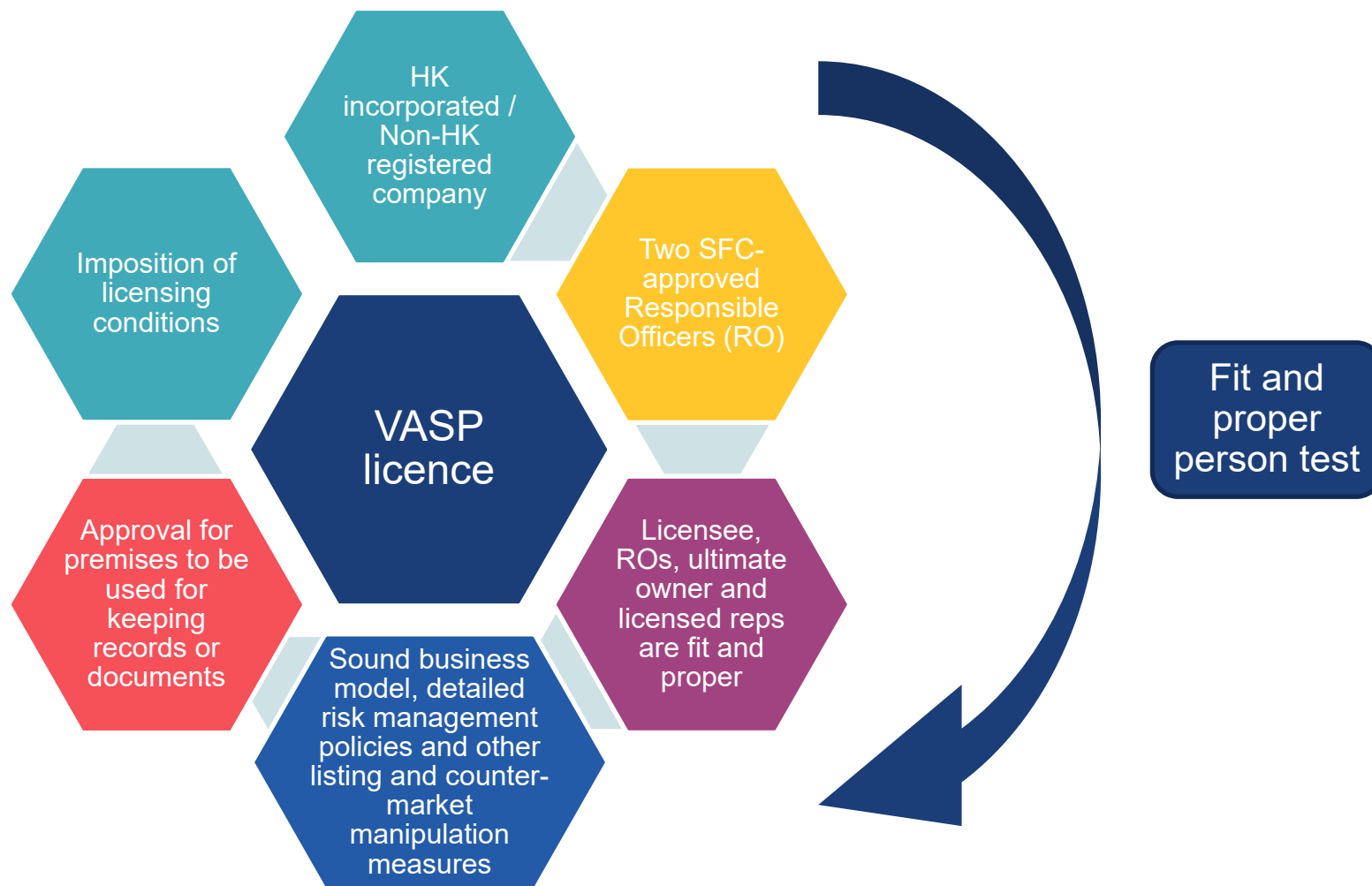
Operating a VA exchange



Definition of virtual asset

- “**Virtual asset**” will be defined under the AMLO as a **cryptographically secured digital representation of value** that:
 - is expressed as a **unit of account** or a **store of economic value**; and
 - either:
 - is used (or is intended to be used) as a **medium of exchange accepted by the public**, for any one or more of the following purposes – (a) payment for goods or services, (b) discharge of a debt, or (c) investment; or
 - provides **rights, eligibility or access to vote** on the management, administration or governance of the affairs in connection with, or to vote on any change of the terms of any arrangement applicable to, any cryptographically secured digital representation of value; and
 - can be **transferred, stored or traded electronically**; and
 - satisfies **other characteristics prescribed by the SFC** by notice published in the Gazette;or
 - is a digital representation of value **prescribed as a virtual asset** by the Secretary for Financial Services and the Treasury by notice published in the Gazette.
- **Not currently in scope** are:
 - digital representations of fiat currencies (including digital currencies issued by central banks (CBDCs))
 - financial assets already regulated under the Securities and Futures Ordinance
 - stored value facilities which are regulated under the *Payment Systems and Stored Value Facilities Ordinance*
 - closed-loop, limited purpose items that are non-transferable, non-exchangeable and non-fungible in nature, such as air miles, credit card rewards, gift cards, customer loyalty programmes and gaming coins

Licensing criteria



Supervision and enforcement

SFC's broad powers



Enter business premises



Routine inspections



Request production of documents



Investigate non-compliance and impose disciplinary sanctions



Appoint auditor to audit affairs, and "associated entity"

Key offences



Offence to carry on or hold oneself out as carrying on a business of providing VA services without a licence



Offence to issue advertisements relating to unlicensed person's provision of VA service



Offence involving fraudulent or deceptive devices etc. in transactions in virtual assets



Offence to fraudulently or recklessly induce others to invest in virtual assets

Enforcement

SFC's disciplinary powers to include:

Public or private
reprimand

Order the person to take
remedial action for any
contravention, act or
omission

Order the person to pay
pecuniary penalty

- Amount not exceeding the greater of HK \$10,000,000 or 3 times the amount of the profit gained or loss avoided by the person

Revoke or suspend a
person's license

Revoke or suspend
approval of an RO

Issue prohibition orders

Enforcement

Injunction and other orders

Restraint or prohibition order

Restoration order

Order appointing a person to administer the property of another person

Order declaring a contract relating to any virtual asset void or voidable

Order directing a person to do or refrain from doing a specified act

Interim orders

Order for payment of damages

Criminal liability

Offence to operate a VA exchange without a licence, or actively market the service of a non-licensed VA service to the public of Hong Kong

Offence to carry on or hold oneself out as carrying on a business of providing VA services without a licence

Offence to issue advertisements relating to unlicensed person's provision of VA service

Offence for failing to ensure compliance with AML/CTF requirements

Offence involving fraudulent or deceptive devices etc. in transactions in virtual assets

Offence to fraudulently or recklessly induce others to invest in virtual assets



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Practical issues for operators
in the VA industry

Practical issues



Sustainability / robust business model



Investor protection



Anti-market manipulation

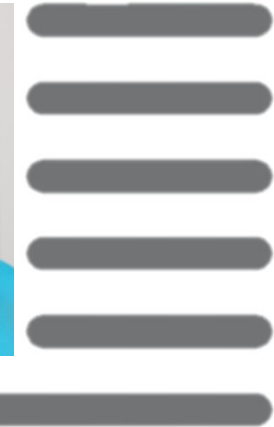


Cybersecurity



AML/CFT

Unlawful touting of crypto security (US\$1.26M penalty)





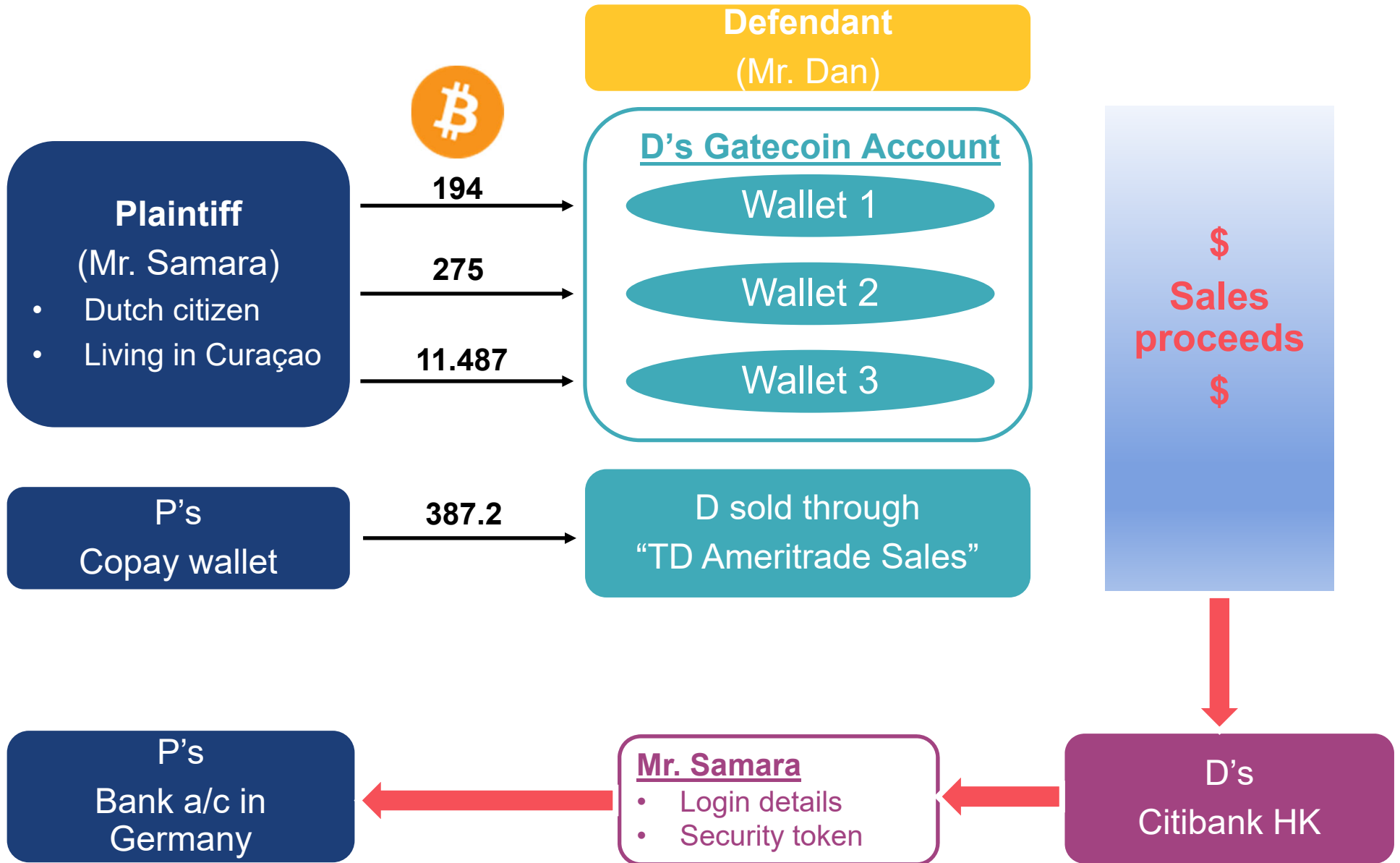
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Recent cryptocurrency
disputes

Nico Constantijn Antonius Samara v Stive Jean Paul Dan

[2022] HKCFI 1254



Nico Constantijn Antonius Samara v Stive Jean Paul Dan

Mareva Injunction

- Good arguable case on fraud and dishonesty
- Risk of dissipation of assets
- Disclosure orders against banks to trace assets

Freeze US\$2.6 million

Proprietary Injunction

Freeze:

- Cash
- Fund units
- Securities
- Insurance policies
- Bitcoin in special account

Nico Constantijn Antonius Samara v Stive Jean Paul Dan

Findings at trial

- D acted as an agent of P to sell P's Bitcoins
- The relevant Bitcoins transferred to D's wallet indeed originated from P, based on a Gatecoin Report and public ledger
- D owed fiduciary duties when dealing with P's Bitcoins and sale proceeds
- D breached his fiduciary duties for failing to account to P for the Bitcoins and sales proceeds and disposing them for D's own benefit

Relief granted

- Declarations that the relevant Bitcoins and sale proceeds were held by D on trust for P
- Order that D procure the transfer of sums and properties representing the fruits of the P's Bitcoins and sale proceeds to P
- Order for all necessary accounts, inquiry and directions
- Order that D shall pay equitable compensation if P is unable to recover the Bitcoins and money in specie in the Gatecoin account (following Gatecoin's liquidation)

Nico Constantijn Antonius Samara v Stive Jean Paul Dan

Observations

Hong Kong Courts can, and will, grant necessary remedies to protect and preserve crypto assets

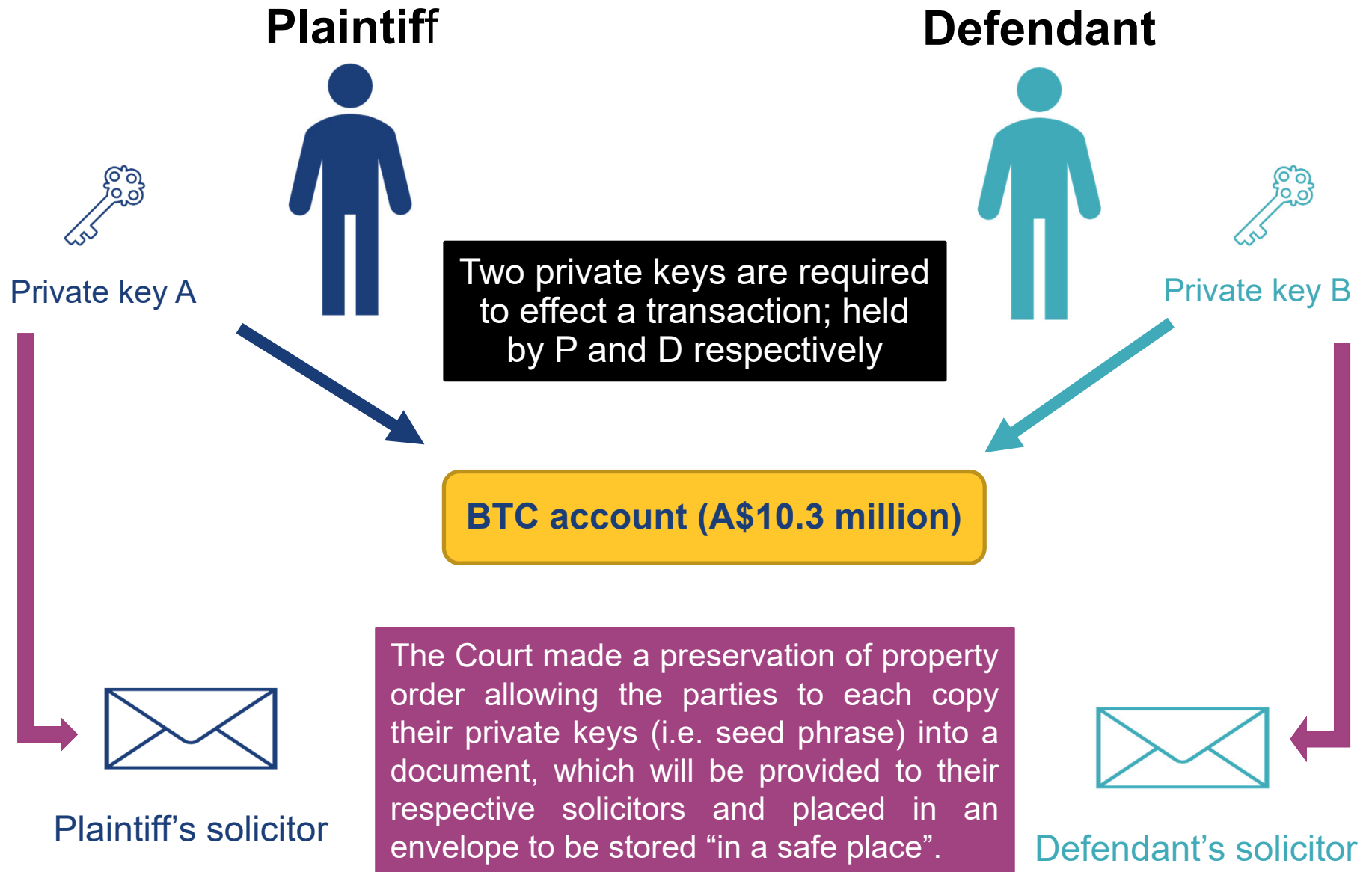
Interim relief helped preserve status quo

Benefits in the use of the blockchain technology – immutable, publicly accessible and traceable

Granting of proprietary remedies suggest that Bitcoin constitute property protected under Hong Kong law

- Bitcoin valued at time of breach: **US\$2,000-US\$4,000**
- Bitcoin valued at date of judgment: **US\$40,000**

Chen v Blockchain Global Ltd; Abel v Blockchain Global Ltd [2022] VSC 92



Duty of crypto software developers?

Tulip Trading Limited v Bitcoin Association for BSV [2022] EWHC 667 (Ch)

Plaintiff

Tulip Trading Limited
(owned by Dr. Wright & his wife)

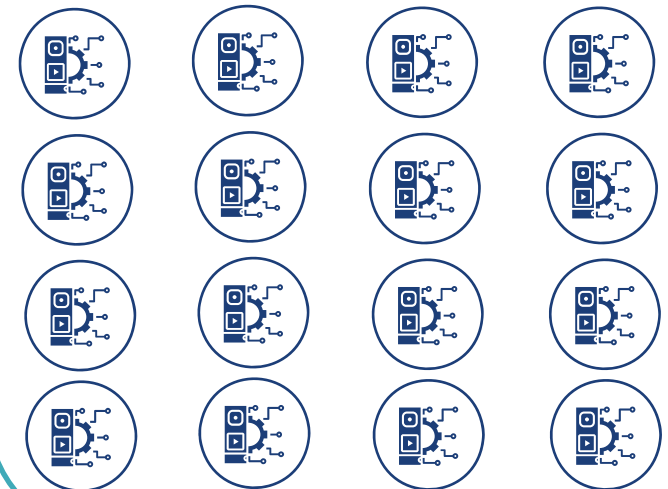
- Dr. Wright's computer was hacked
- Private keys to his bitcoins were erased
- Lost control of his cryptocurrencies



P claimed that D owed it tortious and fiducial duties to take reasonable steps to ensure it regains access to his cryptocurrencies

Defendant
16 open-source

Bitcoin software developers



HELD: The Defendants (i.e. the software developers) owed no fiduciary or tortious duties to crypto asset owners



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Q&A

Presenters



Hannah Cassidy

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Hannah heads the award-winning financial services regulatory practice in Asia, advising clients on contentious and non-contentious matters. Hannah helps financial institutions, listed companies and their senior individuals on high stakes cases involving, for example, systems and controls breaches, anti-money laundering failures, product mis-selling and insider dealing. She is praised by clients for her "very level-headed and practical advice".

Hannah has helped clients in connection with multiple cross-border matters covering Hong Kong, Singapore, Vietnam, Indonesia, Malaysia, Australia, Korea, Japan, the United States, the United Kingdom and Jersey. She has particular expertise in advising clients on the conduct of high-profile board-led, independent investigations, particularly in relation to culture and conduct. She also regularly advises clients on regulatory developments, including in relation to culture and conduct, senior management accountability, ESG, virtual assets and operational resilience.

Hannah's team regularly leads discussions with regulators on behalf of the financial services industry in relation to regulatory reform initiatives. This includes working closely with leading industry bodies, including ASIFMA and AIMA. Hannah is a co-chair of the firm's Global Banks Sector Group, is a member of Women in Finance Asia and regularly speaks on industry panels.



Natalie Curtis

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Natalie is a partner in the firm's Asia financial services regulatory practice. She advises financial institutions and fintech clients on both contentious and non-contentious regulatory and compliance matters in Southeast Asia and Hong Kong.

Natalie has extensive experience advising on financial services licensing (banking, securities, fund manager, payments, VASP, ATS and exchange authorisation by SFC, HKMA and MAS), banking and securities regulation, AML/CFT regulation and enforcement, payment services regulation, asset management, organised markets, data protection/banking secrecy, cybersecurity, operational resilience and technology risk management, senior management accountability, culture & conduct, corporate governance, M&A involving regulated entities, establishing digital/virtual banks, virtual asset/crypto regulation, cross-border marketing, suitability, investor classification, and the cross-border and local impact of regulatory change and development.

Natalie regularly interacts with key APAC regulators and works closely with industry bodies such as ASIFMA and AIMA on regulatory reform and development. She is a member of ASIFMA's fintech working group, deputy co-chair of AIMA's Singapore regulatory committee and was a founding committee member of the Global Blockchain Convergence (a global policy group).

Presenters



Rachael Shek

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Rachael specialises in complex commercial litigation, with a particular focus on banking litigation, corporate loan recovery, joint venture/shareholder disputes, and private wealth disputes.

She has worked with banks, private equity firms and other financial services providers as well as Hong Kong listed companies, global manufacturers and ultra-high net worth individuals.

Rachael is a ranked disputes lawyer by Chambers 2022, 2021, 2020, 2019, and 2018 and is described as being “*efficient, precise and always on point in terms of drafting*”, and praised by clients as “*both legally and commercially sound*”, and for being “*particularly good at handling clients and managing their expectations*”.

Chambers also note that “*Rachael Shek is known for handling a variety of commercial litigation, including asset recovery and shareholder disagreements. She also has noted experience in banking disputes. A market commentator describes her as “a very nice person who is easy to work with.”*”

Originally from the UK, Rachael speaks English, Cantonese and basic Mandarin. She has a bachelor’s degree in law from Newcastle University and a postgraduate certificate in law from the University of Hong Kong. Rachael is qualified to practice in Hong Kong.

Rachael is a contributing editor of Hong Kong Civil Procedure (the Hong Kong White Book), published by Sweet & Maxwell.



Lydia Wong

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Lydia has experience in advising banks, financial institutions, listed companies, fintech companies and high net worth individuals on contentious and non-contentious financial regulatory and compliance matters.

Lydia’s contentious experience includes advising on internal and regulatory investigations, regulatory enquiries and enforcement regarding breaches of anti-money laundering regulation, regulatory reporting, system and control breaches and mis-selling.

She also advises on non-contentious matters including financial services licensing and a broad range of compliance issues including client on-boarding, anti-money laundering compliance, compliance with regulatory circulars and guidelines, cybersecurity issues and disclosure requirements.

Lydia’s experience includes advising:

- a cryptocurrency exchange on its client agreements
- digital asset trading platform/cryptocurrency exchange on regulatory issues concerning the products they offered and whether they would be in scope of the Hong Kong VASP licensing regime
- a multinational technology company on issues relating to digital payments and review of its privacy policy
- a German headquartered financial services group on Hong Kong AML/CFT regulations and outsourcing arrangements
- a Hong Kong virtual bank on its customer terms and conditions for its new securities trading business line

Resources

HSF Bulletins

- [Hong Kong Court summarises features of Bitcoin, digital keys and “hot” and “cold” wallets, 12 July 2022](#)
- [Hong Kong VASP licensing regime to take effect on 1 March 2023, 27 June 2022](#)
- [Unravelling the cryptic – Hong Kong Court helps victim recover crypto-assets against pilfering agent, 23 June 2022](#)
- [Hong Kong: will Courts accept cryptocurrency as a security for costs?, 27 May 2022](#)
- [Crypto assets go mainstream \(2\) – Hong Kong Insurance Authority guidance on virtual asset-related activities, 8 April 2022](#)
- [Crypto assets go mainstream – new SFC and HKMA guidance for intermediaries and banks on virtual asset-related activities, 2 March 2022](#)
- [Hong Kong Monetary Authority provides update on proposed regulatory framework for payment-related stablecoins and upcoming crypto-asset guidance, 21 January 2022](#)

Regulatory publications

- [HKMA position paper on e-HKD: Charting the next steps, 20 September 2022](#)
- [Legislation Council brief on the Anti-money Laundering and Counter-Terrorist Financing \(Amendment\) Bill 2022, 22 June 2022](#)
- [SFC reminds investors of risks associated with non-fungible tokens, 6 June 2022](#)
- [HKMA discussion paper on e-HKD: A policy and design perspective, 27 April 2022](#)
- [SFC and HKMA joint circular on intermediaries’ virtual asset-related activities, 28 January 2022](#)
- [Regulatory approaches of the HKMA in relation to virtual assets and virtual asset service providers, 28 January 2022](#)
- [Regulatory approaches of the Insurance Authority in relation to virtual assets and virtual asset service providers, 28 January 2022](#)
- [HKMA discussion paper on crypto-assets and stablecoins, 20 January 2022](#)
- [HKMA technical whitepaper on retail central bank digital currency, 4 October 2021](#)

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