

Legal Commentary

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Metaverse: A Rational View of How New Rules against Illegal Fundraising Affect the Virtual Currency Industry

Authors: Wei QUAN | Kanxi LIAO | Bo ZHENG | Haowen WANG¹

On February 24, 2022, the Supreme People's Court ("SPC") issued its *Decision on Revising the Interpretations of the Supreme People's Court on the Specific Application of Law in the Trial of Criminal Cases involving Illegal Fundraising* (Fa Shi [2022] No. 5, the "New Rules"). The addition of "virtual currency trading" related content in the New Rules has aroused waves of guesswork, inundating the market with eye-grabbing headlines such as "crypto trading defined as illegal fundraising" and "virtual currency traders to be sentenced to fixed-term imprisonment". Why do the New Rules touch on virtual currency? Will it substantially affect the risk of virtual currency practices? This commentary seeks to answer these questions.

Changes made in the New Rules – not all virtual currency trading constitutes illegal fundraising

The New Rules make quite a number of amendments to the previous *Interpretations of the Supreme People's Court on the Specific Application of Law in the Trial of Criminal Cases involving Illegal Fundraising* (Fa Shi [2010] No. 18). However, only one of these amendments concerns virtual currency, as specified in the following table.

Original description in the New Rules	Item 8 of Article 2 is revised to read "illegally taking in deposits by means of online lending, equity investment, virtual currency trading, or otherwise."
Before revision	[Article 2] Whoever commits any of the following acts, which meets the conditions stipulated in Article 1, paragraph 1 hereof , shall be convicted of the crime of illegally taking in deposits from the general public and be punished in accordance with Article 176 of the Criminal Law: 1. Illegally taking in deposits without the true substance of a housing sale or not primarily for purposes of a housing sale, such as rebate sales, after-sale leases, agreed repurchases, selling shares in housing, and other means;

¹ Hong Song, a Han Kun intern, also contributed to this legal commentary.

	<p>.....</p> <p>8. illegally taking in deposits by means of equity investment;</p> <p>.....</p> <p>11. Any other acts by which deposits are illegally taken in.</p>
<p style="text-align: center;">After revision</p>	<p>[Article 2] Whoever commits any of the following acts, which meets the conditions stipulated in Article 1, paragraph 1 hereof, shall be convicted of the crime of illegally taking in deposits from the general public and be punished in accordance with Article 176 of the Criminal Law:</p> <p>1. Illegally taking in deposits without the true substance of a housing sale or not primarily for purposes of a housing sale, such as rebate sales, after-sale leases, agreed repurchases, selling shares in housing, and other means;</p> <p>.....</p> <p>8. illegally taking in deposits by online lending, equity investment, virtual currency trading, and other means;</p> <p>.....</p> <p>12. Any other acts by which deposits are illegally taken in.</p>

Meanwhile, in his response to media inquiries concerning the New Rules, the relevant principal of the 3rd Criminal Division of the SPC stated that “Article 2 of the initial Interpretations set forth ten categories of illegal fundraising activities along with a miscellaneous provision. The revised Interpretations, taking into consideration new situations in judicial practice and newly arising forms of crime, **include new types of illegal deposit-taking activities such as online lending, virtual currency trading, and financial leasing** as Items 8 and 9 of this Article 2, and introduce as Item 10 a new category of “illegally taking in deposits by providing ‘elderly care services’, investing in ‘elderly care projects’, selling ‘products for the elderly’ or otherwise”, **which provides a legal basis for criminalizing and punishing illegal fundraising activities in such areas as P2P, virtual currencies, and elderly care.**

Given the above, the New Rules mainly specify the market status quo where “virtual currency” is used as a vehicle for illegal fundraising, and by no means indicate that all forms of virtual currency trading are indistinguishably criminalized as illegal fundraising. Notably, in as early as January 2021, the State Council indicated in its *Regulations on Prevention and Disposition of Illegal Fund-raising* (the “**Regulations**”) that virtual currency trading is prone to involving illegal fundraising and should be an investigation focus. Article 19 of the Regulations reads: “**For any of the following suspected illegal fundraising practices within a local administrative region**, the leading department for dealing with illegal fundraising practices shall organize the competent administrative authorities and regulators of the industry, as well as the branch or dispatched office of the financial administrative department under the State Council, to carry out investigation and identify such practices: (II) pooling funds in the name of offering or transferring equity or creditor’s rights, raising funds, selling insurance products, or **engaging in various asset management, virtual currency, or financial leasing business, etc.**”. Therefore, the New Rules are not the first effort made by regulators to legislate against illegal fundraising via virtual currency trading.

The same approach should be adopted to understand other illegal fundraising scenarios added in the New

Rules. That is to say, although activities such as “online lending”, “financial leasing”, “equity investment” and “elderly care projects” may become a vehicle for illegal fundraising, such activities do not naturally constitute illegal fundraising. If the concept applies that “virtual currency trading equals illegal fundraising”, all other activities set forth in the above laws and regulations would also be identified as illegal fundraising. Such way of thinking, which is promoted by a small number of self-media, is more or less for clickbait and lacks a legal basis.

What types of virtual currency trading constitute illegal fundraising – the key lies in “general public involvement” and “luring with promised gains”

The New Rules do not broaden or replace the established scope and elements for identifying illegal fundraising. Examination of the following four core elements is still required to determine whether a trading activity constitutes illegal fundraising:

- **Illegality:** pooling funds without the legal approval of competent authorities or in the form of lawful business operations;
- **Publicity:** carrying out public promotions via media, promotional events, leaflets, cellphone messages, and other means;
- **Inducement with promised gains:** promising to repay the principal with interest accrued thereon or to pay returns in such forms as cash, in-kind, and equity within a given time limit; and
- **Sociality:** pooling funds from the general public, namely unspecified targets in society.

A person who raises funds in a manner that meets these four elements may be considered to have committed the crime of “illegally taking deposits from the general public”; if the foregoing fundraising activity is carried out for the purpose of illegal possession by means of fraud, it may also be found to constitute the crime of “fundraising fraud”. Among the foregoing elements, the key to identifying the risk of illegal fundraising is whether the activity in question involves the “general public” (i.e., whether a public promotion is carried out and caters for unspecified targets), and whether the activity “lures the targets with promised gains” (e.g., establishing a fixed-return mechanism, a dividend payout mechanism, or a repurchase mechanism).

How should market players respond?

Marked by the *Notice on Further Preventing and Resolving the Risks of Virtual Currency Trading and Speculation*, which was jointly issued on September 15, 2021 by the People’s Bank of China and nine other national-level departments and commissions, Chinese regulators are currently tightening their overall crackdown on illegal activities in China’s virtual currency industry. Admittedly, the New Rules do not increase the legal risks faced by market players, meaning that “activities that were legal before the issuance of the New Rules remain legal after their issuance, and activities that were illegal remain illegal”. Nevertheless, the New Rules indeed demonstrate that regulators have attached greater importance to illegal fundraising activities conducted via virtual currency trading, which is also a response to the large number of illegal virtual currency fundraising cases arising in judicial practice over the past few years.

Given the current regulatory landscape, market players in industries related to the metaverse, non-fungible tokens, and blockchain are advised to defuse illegal fundraising risks in the following respects:

- **Metaverse:** “virtual currencies” under metaverse business models mainly appear as “currency units”. Market players should position the function of virtual currencies under metaverse as similar to “in-game currencies” and follow regulatory requirements related to in-game currencies. They should strictly prevent two-way exchanges between virtual currencies and legal currencies, so as to avoid any association or link with substantive rights and interests offline.
- **Non-fungible tokens (NFTs):** It is advisable to set up certain access permission mechanisms to attenuate the general and public nature of NFT products. Meanwhile, NFT sellers should downplay the “investment” and “speculative” attributes of their products in their promotional activities and trading mechanisms, avoiding expressions such as “principal and benefits guaranteed”, “lucrative returns”, and “unlimited future earnings” in their advertisement and issuance rules. Also, it is not advisable for now to formally open a secondary market for NFT transfers.
- **Overseas projects:** With respect to the various blockchain business forms located purely overseas (e.g. overseas exchanges, overseas mining farms, and overseas crypto funds), market players are advised to adhere to the compliance redlines set out in the *Notice on Further Preventing and Resolving the Risks of Virtual Currency Trading and Speculation* and to take proper measures to block any publicity and promotional endeavors targeting residents in the PRC, so as to ensure that such projects will not have a public impact in the PRC market.

Conclusion

The tightening crackdown on illegal activities in the virtual currency industry by Chinese regulators has greatly increased compliance pressure on market participants, who now turn pale even at the mere mention of new government policies. Nonetheless, in our opinion, blockchain, a business form supported and encouraged by national policies, remains a promising field with a large development space, as long as relevant business activities are carried out in compliance with regulatory requirements. Meanwhile, market players should treat relevant news and voices with calm and maintain stable operations and performance, seeking to understand the real regulatory purposes and compliance redlines underlying applicable rules and provisions in a rational manner.

Important Announcement

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If you have any questions regarding this publication, please contact:

Wei QUAN

Tel: +86 21 6080 0946

Email: wei.quan@hankunlaw.com