

THE VIRTUAL
CURRENCY
REGULATION
REVIEW

SIXTH EDITION

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Paul Anderson

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Clare Bolton – clare.bolton@lbresearch.com.

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CHINA

TieCheng Yang, Raymond Yan and Ivy Xu¹

I INTRODUCTION TO THE LEGAL AND REGULATORY FRAMEWORK

In China,² regulators have long been cautious and have been closely monitoring the issuance and trading of virtual currencies since the advent of Bitcoin in 2008. Aside from the digital yuan (e-CNY) issued by the People's Bank of China (PBoC), China does not recognise virtual currencies (or cryptocurrencies) as legal tender and strictly prohibits their circulation in the market.

While a unified legal and regulatory regime governing virtual currencies has yet to be established, the People's Republic of China (PRC) regulators have successively promulgated rules intended to govern virtual currencies in several different ad hoc notices and circulars in response to the growth of financial fraud and crimes caused by unregulated virtual currencies and the potential threat to the stability of China's financial system and the yuan. Conversely, China generally encourages the application and R&D of blockchain technology,³ although the underlying blockchain technology is required to be strictly separated from speculative applications and financial use of virtual currencies.

In addition, the development and trading of non-fungible tokens (NFTs) are not currently explicitly prohibited. These issues will be discussed in Section X.

This section will provide an overview on the key rules governing virtual currencies and discuss the legal status of virtual currencies from the perspectives of the PRC laws and judicial practice.

i Key rules

The development of key rules shows PRC regulators' tendency to tighten their regulatory stance on virtual currencies and virtual currency-related business activities (collectively, the Key Prohibition Rules). Below is a timeline of the development of these rules.

1 TieCheng Yang is a partner, Meng (Raymond) Yan is a counsel and Wenli (Ivy) Xu is an associate at Han Kun Law Offices.

2 'China' and the 'PRC' stand for the People's Republic of China. This chapter addresses the relevant legal issues under the PRC laws only, without accounting for the laws that are applicable to each of the Hong Kong Special Administrative Region, Macau Special Administrative Region and Taiwan Region. The geographic jurisdiction scope shall be interpreted accordingly. This China chapter also discusses the legislative developments on virtual currencies in Hong Kong under the relevant sections.

3 'Blockchain technology R&D and application' is one of the encouraged industries for foreign investment according to the Catalogue for the Encouragement of Foreign Investment Industries (2022).

Circular on Guarding against the Risks of Bitcoin

On 5 December 2013, PBoC, the Ministry of Industry and Information Technology (MIIT), the China Banking Regulatory Commission (CBRC)⁴, the China Securities Regulatory Commission (CSRC) and the China Insurance Regulatory Commission (CIRC) jointly promulgated the Circular on Guarding against the Risks of Bitcoin (the Bitcoin Risk Circular), according to which Bitcoin is defined as a specific type of virtual commodity by its nature that does not possess the status of legal tender and shall not be circulated for use as currency. Under the Bitcoin Risk Circular, financial institutions and payment firms are prohibited from trading Bitcoin (as the central counterparties or otherwise), providing exchange services between Bitcoin and yuan, engaging in Bitcoin insurance services, and providing any other services in relation to Bitcoin, directly or indirectly, within China. During this time, internet companies providing Bitcoin registration and trading services were not prohibited, as long as they were in compliance with the relevant PRC telecommunications administration and filing requirements as well as anti-money laundering laws and regulations. According to the Bitcoin Risk Circular, the general public was free to trade Bitcoins on the internet at their own risk.

Circular on the Prevention of Financing Risks of Initial Coin Offerings

On 4 September 2017, PBoC and six other PRC regulators (the Cyberspace Administration of China (CAC), MIIT, the State Administration for Market Regulation (SAMR), CBRC, CSRC and CIRC) jointly promulgated the Circular on the Prevention of Financing Risks of Initial Coin Offerings (the ICO Circular). According to the ICO Circular, digital tokens used in initial coin offerings (ICOs) are not considered currencies issued by a competent authority and should not be circulated or used as legal tender. As a result, all types of ICO financing activities were immediately suspended from the date of the ICO Circular. In addition, digital token financing and trading platforms (including websites and mobile application programmes (apps)) are prohibited from:

- a* providing conversion services between tokens and legal tender;
- b* selling or purchasing (as the central counterparty or otherwise) tokens or other virtual currencies; or
- c* providing pricing information or data intermediary services in relation to tokens.

Alert on Preventing the Risks of Overseas ICO and 'Virtual Currency' Transactions

On 26 January 2018, the National Internet Finance Association of China (NIFA) promulgated the Alert on Preventing the Risks of Overseas ICO and 'Virtual Currency' Transactions (the ICO Risk Alert). In addition to reiterating the ICO Circular, the ICO Risk Alert further points out that in light of the rectifications and administration of domestic ICO activities and virtual currency trading platforms by PRC regulators, some investors in China seek to conduct trading activities on offshore trading platforms. The ICO Risk Alert gives warnings to investors in China as to their potential losses in connection with domestic controls on the

⁴ CBRC (the banking regulator) and CIRC (the insurance regulator) merged in 2018 into CBIRC. Further, the National Administration of Financial Regulation was established on the basis of and replaced CBIRC from 18 May 2023, to take over all functions of CBIRC.

internet access and payment channels to offshore trading platforms, as well as the various risks associated with offshore trading platforms as a result of the general lack of regulations, including system security, market manipulation and money laundering.

Alert on Preventing the Risks of Illegal Fund Raising in the Name of ‘Virtual Currency’ and ‘Blockchain’

On 24 August 2018, the China Banking and Insurance Regulatory Commission (CBIRC), CAC, the Ministry of Public Security (MPS), PBoC and SAMR jointly issued the Alert on Preventing the Risks of Illegal Fund Raising in the Name of ‘Virtual Currency’ and ‘Blockchain’, giving warnings to Chinese investors regarding illegal fund raising activities in the name of ‘financial innovation’ or ‘blockchain’, such as overseas blockchain projects falsely advertised as ‘high quality projects’ and virtual currency speculation in the name of ICOs, initial fork offerings and initial exchange offerings.

Public Announcement on Preventing Speculative Risks related to Virtual Currency Transactions

On 18 May 2021, NIFA, the China Banking Association (CBA) and the Payments and Clearing Association of China (PCAC),⁵ jointly issued the Public Announcement on Preventing Speculative Risks related to Virtual Currencies Transactions (the Virtual Currencies Transaction Announcement), according to which the following are in breach of laws and regulations:

- a* conducting exchange services between virtual currencies and legal tender or among various virtual currencies;
- b* buying and selling virtual currencies as a central counterparty;
- c* providing information intermediation and pricing services for virtual currencies transactions; and
- d* engaging in ICOs and virtual currency derivative transactions.

Such activities may result in criminal liability relating to illegal fundraising, illegal issuance of securities, and illegal sale of tokens and notes. Per the Virtual Currency Transaction Announcement, financial institutions, payment institutions and internet platforms are also banned from providing virtual currency-related services.

Circular on the Rectification and Management of Virtual Currency Mining

On 3 September 2021, the National Development and Reform Commission (NDRC), the Publicity Department of the Communist Party of China Central Committee, CAC, MIIT, MPS, the Ministry of Finance, PBoC, the State Administration of Taxation (SAT), SAMR, CBIRC and the National Energy Administration jointly promulgated the Circular on the Rectification and Management of Virtual Currency Mining (the VCM Circular), which bans new virtual currency mining operations in China and imposes restrictive measures and stringent supervision on existing virtual currency mining projects.

⁵ NIFA, CBA and PCAC are national self-regulatory organisations in the fields of internet finance, banking, and payment and clearing services, respectively. NIFA and PCAC are supervised by PBoC, and CBA is supervised by CBIRC.

Circular on Furthering Preventing and Handling the Speculative Risk related to Cryptocurrency Transactions

On 15 September 2021, PBoC, CAC, the Supreme People's Court (SPC), the Supreme People's Procuratorate, MIIT, MPS, SAMR, CBIRC, CSRC and the State Administration of Foreign Exchange jointly issued the Circular on Furthering Preventing and Handling the Speculative Risk related to Cryptocurrency Transactions (Circular No. 237). In addition to reaffirming key positions as set out in the Virtual Currency Transaction Announcement, Circular No. 237 declares that providing services to residents in China through the internet by a virtual currency exchange outside China also constitutes an illegal financial activity. The employees of virtual currency exchanges outside China who are located in China and the legal persons, non-legal persons and individuals providing marketing or payment and settlement or technical support to the exchanges, who know or should have known that this exchange operates virtual currency business activities, will also be held liable in accordance with the laws and regulations. Circular No. 237 provides the most broad-brush and stringent regulation and reflects PRC regulators' current position towards virtual currencies and virtual currency-related business activities.

ii Legal status of virtual currencies

According to Circular No. 237, virtual currencies shall bear certain key features, including:

- a* not being issued by a governmental monetary authority;
- b* being created based on crypto technologies, distributed ledgers or other similar technologies; and
- c* existing only in digital form.

Circular No. 237 also enumerates certain types of virtual currencies, including Bitcoin, Ether and Tether. These features are indicative and non-exhaustive in nature, and virtual currencies bearing similar characteristics are also included in this definition.

Despite the strict ban on the circulation and use of virtual currencies as legal tender, no laws or regulations deny the inherent value of virtual currencies as a type of virtual commodity. In 2013, the Bitcoin Risk Circular recognised 'virtual currencies' such as Bitcoin as 'virtual commodities', enabling the private holding or trading of virtual currencies.

However, the laws and regulations that regulate virtual currencies as commodities remain unclear. Regulatory controls imposed on virtual currencies were further strengthened after 2013 and PRC regulators are now granted with more discretion in interpreting the nature of virtual currency-related business activities that fall within their purviews. In this respect, judicial practice diverges among different Chinese courts.

Some courts view the value of virtual currencies as unascertainable in respect to legal tender, and civil claims regarding the private exchange of virtual currencies have been rejected or the relevant contracts were found invalid for violating the Key Prohibition Rules. This was particularly so following promulgation of the ICO Circular.⁶

⁶ See Civil Judgment of Zunyi Intermediate People's Court of Guizhou Province (2021) Qian 03 Min Zhong No. 9625; Beijing No. 3 Intermediate People's Court's Civil Judgment (2021) Jing 03 Min Zhong No. 10254; and Civil Judgment of Taizhou Intermediate People's Court of Zhejiang Province (2022) Zhe 10 Min Zhong No. 352.

Nevertheless, other courts have been permissive towards virtual currencies and related activities in certain aspects, such as by holding:

- a virtual currencies are virtual commodities that possess economic value and thus their private exchange between persons do not violate the Key Prohibition Rules; and
- b purchase agreements in respect of virtual currency trading are valid as they do not violate mandatory legal requirements or public policies.⁷

In May 2022, in a Bitcoin-related case,⁸ the Shanghai High People's Court confirmed that Bitcoins possess economic value, the number of which is infinite, and they can be used and disposed by the holders – all such attributes demonstrate Bitcoins can be deemed as virtual assets and protected according to the PRC Civil Code.

In April 2023, the SPC published the Minutes of the National Courts' Conference for Financial Trials (Draft for Comments) (the Draft Courts' Conference Minutes), unifying the application of laws on certain complex legal issues encountered by courts during juridical practice. The Draft Courts' Conference Minutes include a section specifically addressing virtual currency-related financial trials. The SPC expressly confirmed that virtual currencies shall have the attribute of virtual assets, and required that case-specific analysis be applied in individual virtual currency-related cases in light of the changing public policies at the time:

- a for contracts involving a small amount of use of virtual currencies for trade or labour payment, unless there exist other legal grounds for contractual invalidity, such contracts shall still be held as valid, and the court shall support a party's request for the delivery of virtual currencies according to the contracts; and
- b for contracts being used for regular payment of virtual currencies to exchange fiat currencies or commodities, such contracts shall be held as invalid. It reiterates the Chinese regulators' position that virtual currencies are prohibited from being circulated on the market to replace yuan.

On the other hand, the Hong Kong Court of First Instance, for the first time, confirmed that cryptocurrency is a property and can be held on trust under the Hong Kong law, for passing the four-prong test⁹ established by Lord Wilberforce in *National Provincial Bank v. Ainsworth* [1965], in its landmark decision *Re Gatecoin Limited*¹⁰ in 2023.

In conclusion, virtual currencies, by their nature, are difficult for the Chinese government to control and are often abused for purposes of arbitrage or circumventing capital controls, which may adversely affect the value of the yuan. Faced with technological challenges posed by the encrypted and anonymous aspects of virtual currencies, China has opted for strengthening monetary regulation by promulgating the Key Prohibition Rules. Nevertheless, recent judicial practice indicates that there is a tendency towards the recognition of virtual currencies as virtual assets by the PRC courts, so long as this does not result in the violation of mandatory PRC laws or public policies. This is also in line with the common

7 See Civil Judgment of *Beijing High People's Court* (2020) Jing Min Zhong No. 747; and Civil Judgment of *Shanghai No.1 Intermediate People's Court* (2021) Hu 01 Min Zhong No. 11624.

8 See Civil Judgement of *Shanghai Baosban District People's Court* (2020) Hu 0113 Min Chu No. 23704.

9 To constitute a property, it shall be (1) definable, (2) identifiable by third parties, (3) capable in its nature of assumption by third parties and (4) have some degree of permanence or stability.

10 See Civil Judgment of High Court of the Hong Kong Special Administrative Region, (2023) HKCFI No. 914.

law development in respect of cryptocurrencies in Hong Kong, the *Re Gatecoin Limited* case. Additionally, according to the Draft Courts' Conference Minutes, PRC courts are required to closely monitor the changes and adjustment in financial regulations and public policies in different times when deciding the legal effect of virtual currency-related activities.

II SECURITIES AND INVESTMENT LAWS

The issuance and trading of securities is principally governed by the PRC Securities Law.¹¹ Article 2 of this Law enumerates the forms of 'securities' to include listed shares, corporate bonds, depository certificates and other securities recognised by the State Council in accordance with the PRC laws. The listing and trading of government bonds and securities investment funds are also subject to the PRC Securities Law and the issuance and trading of asset-backed securities and asset management products are regulated under separate regulations formulated in accordance with the principles of the PRC Securities Law. The establishment of a securities company is required to be approved by CSRC, and no entities or persons are allowed to engage in securities businesses in the name of securities company without approval from CSRC.¹²

Virtual currencies have not been characterised as 'securities' by CSRC. In an article published by the general director of the PBoC Monetary Policy Department,¹³ issues regarding the regulation of ICOs were discussed during the last amendment to the PRC Securities Law in 2019. Some legal experts have proposed that the scope of the term 'securities' should be expanded to include investment contracts, so that more types of financial instruments similar to traditional securities can be regulated. However, this proposal was not reflected in the final amendments.

While some may argue that CSRC's silence is contrary to its aim at extending the regulatory purview to ensure a smooth innovation and development of China's capital market and the investor protection,¹⁴ we believe it is consistent with the PRC regulators' current position that financing through 'virtual currencies' is discouraged. Time is not ripe for treating virtual currencies as 'securities' because CSRC needs more time and resources to deal with the technological uncertainties involved. Under the current PRC legal regime, public offerings of virtual currencies in China may constitute the illegal offering of securities without approval or in a disguised form, and the entities and responsible persons may be subject to administrative penalties depending on the seriousness of the violation.¹⁵ In Hong Kong, security token offerings (STOs) are recognised by the Securities and Futures Commission (SFC) but the persons who market and distribute STOs are required to be licensed or registered for Type 1 regulated activity (dealing in securities) under the Securities and Futures Ordinance (SFO),

11 See the PRC Securities Law (Revised in 2019) promulgated by the Standing Committee of the National People's Congress on 28 December 2019 and effective as of 1 March 2020.

12 See Article 9 of the PRC Securities Law.

13 Sun Guofeng, Chen Shi, The Legal Regulatory Path of American Non-sovereign Digital Currencies [J]. *China Finance*, 2020(16): 84–85.

14 See the public announcement issued by CSRC after the promulgation of the PRC Securities Law at <http://www.csrc.gov.cn/csrc/c100028/c1000854/content.shtml> (Chinese only).

15 See Article 180 of the PRC Securities Law.

unless an exemption applies, and shall be subject to the securities laws of Hong Kong.¹⁶ In addition, centralised online trading platform offering trading of STOs shall also obtain a Type 7 licence (providing automatic trading services).

III BANKING AND MONEY TRANSMISSION

In general, under the PRC laws, money transmission can be processed through commercial banks and licensed payment firms.¹⁷ As is frequently reiterated,¹⁸ financial institutions and payment firms are prohibited from providing services for virtual currency-related business activities, including account opening, money transmission and the clearing and settlement of funds.

In 2021, PBoC held regulatory talks with several banks and payment firms¹⁹ in relation to their involvement in providing services for speculating in virtual currencies. PBoC emphasised that banks and non-bank payment platforms should strictly abide by the regulatory requirements as provided by the Bitcoin Risk Circular and the ICO Circular, effectively fulfil their obligations in client identity verification and improve their ability to monitor virtual currency speculation activities.²⁰ More heightened regulations with higher standards are expected to be imposed on commercial banks, payment firms and clearing institutions in the monitoring and control of the illegal funds flow for virtual currencies.²¹

IV ANTI-MONEY LAUNDERING

The PRC Anti-Money Laundering Law and the PRC Counter-Terrorism Law lay the foundation for China's anti-money laundering (AML) and counterterrorist financing (CTF) regime. All financial institutions established within China and certain non-financial institutions are required to comply with the various regulatory requirements provided thereunder. Money laundering is also a criminal offence under the PRC Criminal Law.²²

PBoC is the primary financial regulator for AML matters. In 2021, PBoC issued the Measures for Supervision and Administration of Anti-Money Laundering and Counter-Terrorist Financing for Financial Institutions, which represent a solid step to unify and refine China's supervisory mechanism for AML and CTF and to align China's

16 See SFC's Statement on Security Token Offerings dated 28 March 2019 on its website at <https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/Statement-on-Security-Token-Offerings>.

17 Non-banking online payment service providers may also provide payment services and carry out money transmissions, provided that they have obtained a payment service licence from PBoC. The eligibility requirements are provided in the Administrative Measures of People's Bank of China on Payment Services Provided by Non-financial Institutions promulgated by PBoC on 14 June 2010 and effective from 1 September 2020.

18 See, for example, the Bitcoin Risk Alert and Circular No. 237.

19 Such banks and payment firms include the Industrial and Commercial Bank of China, the Agricultural Bank of China, the China Construction Bank, the Postal Saving Bank of China, the Industrial Bank and Alipay. See news at <http://finance.people.com.cn/n1/2021/0622/c1004-32137422.html> (Chinese only).

20 See news on PBoC's website at http://www.gov.cn/xinwen/2021-06/22/content_5619940.htm (Chinese only).

21 See news at http://m.people.cn/n4/0/2022/0414/c125-15535809_4.html (Chinese only).

22 See Article 191 of the PRC Criminal Law.

AML/CTF regulatory regime with prevailing international practices.²³ CBIRC and CSRC have also issued several AML/CTF rules and regulations to regulate financial institutions that fall within their respective regulatory purviews.²⁴

PRC regulators have long perceived virtual currencies as presenting an increased risk of money laundering. According to the Bitcoin Risk Circular, even when internet companies were still allowed to provide Bitcoin registration and trading services, these service providers were explicitly required to comply with AML requirements and take effective AML measures in their operations, including identifying users, requiring real-name registration, and recording users' names and identity numbers. It is further required that the service providers should report suspicious transactions and cooperate with PBoC's AML investigations. Given the anonymity of virtual currencies, China has been actively developing and applying new technologies to monitor the illicit proceeds laundered through the use of virtual currencies.

The China Anti-Money Laundering Monitoring and Analysis Centre (CAMLMAC) was established in 2004 as an affiliate to PBoC. During money laundering investigations, CAMLMAC is responsible for receiving and analysing suspicious transaction information, for reporting the results of its analysis to PBoC, and for offering support to PBoC and other regulators. CAMLMAC has also been cooperating with offshore financial intelligence units in other jurisdictions in the investigation of cross-border money laundering activities.²⁵

V REGULATION OF EXCHANGES

From the date on which the ICO Circular came into force, all types of token financings have been banned and exchange platforms are no longer allowed to carry out the following:

- a* offer exchange services among tokens, virtual currencies and fiat money;
- b* buy or sell tokens or virtual currencies (as central counterparties or otherwise); or
- c* provide pricing or information intermediary services for tokens or virtual currencies.

Once the ICO Circular came into force, many virtual currency exchange platforms relocated outside China to circumvent Chinese regulations and continued to provide services to PRC residents on a cross-border basis via the internet. Circular No. 237 further stipulates that services provided by offshore virtual currency exchange platforms to residents within the

23 For details, please see the newsletter published by Han Kun Law Office: Closer to International Practice – China's New AML Rules.

24 The AML rules issued by CBIRC and CSRC primarily include the Measures for Administration of Client Due Diligence and Maintenance of Clients' Identity Information and Transaction Records by Financial Institutions, the Measures for Administration of Anti-money Laundering and Counter-terrorist Financing by Banking Financial Institutions, and the Measures for the Implementation of Anti-Money Laundering in the Securities and Futures Sector.

25 See <http://www.pbc.gov.cn/en/3688066/3688095/3689391/index.html>.

PRC also constitute illegal financial services. In this respect, in addition to exchange platform operators, Circular No. 237 holds liable the following PRC domestic entities or persons involved in providing services to PRC residents by offshore exchange platforms:

- a* PRC domestic staff working for the offshore trading platform; and
- b* legal persons, organisations and natural persons who provide marketing and advertising services, payment settlement and technology support for offshore trading platforms, provided that they were or should have been aware that the offshore trading platform was engaging in virtual currency-related business activities.

Entities and natural persons in violation of the ICO Circular and Circular No. 237 may be ordered to take rectification measures (such as to shut down illegal online platforms or mobile apps) or be subject to suspension of business (or both), or even criminal liability if any criminal offences are committed.²⁶

Notably, Chinese authorities have recently strengthened their regulatory oversight of offshore entities' cross-border provisions of financial services or marketing to Chinese customers from the following aspects:

- a* imposing sanctions or penalties on offshore platforms that target PRC residents for illegal financial services – for instance, PBoC has blocked over 100 virtual currency trading platforms (including their onshore websites, WeChat accounts) that placed their servers offshore but provided virtual currency trading access for PRC residents;²⁷
- b* reiterating China's intention to crack down on unlicensed cross-border financial services – some senior officials of Chinese financial regulators have repeatedly emphasised that cross-border provision of financial services must be properly licensed and authorised under the PRC laws and that it is illegal for both offshore and domestic institutions to provide Bitcoin and ICO trading services to PRC residents through overseas websites;²⁸ and
- c* seeking regulatory cooperation for cross-border financial services – the PRC regulators are also seeking to cooperate with competent financial regulators in other jurisdictions to take action against unlicensed cross-border financial products and services offered to PRC customers.²⁹

26 See Articles 2, 10, 12 and 13 of Circular No. 237 and Articles 1 and 3 of the ICO Circular.

27 See news at <http://capital.people.com.cn/n1/2018/0709/c405954-30134178.html> (Chinese only).

28 The information comes from the speech delivered by Mr Sun Tianqi, the Chief Director of PBoC Financial Stability Bureau. On 7 January 2022, SUN repeatedly commented on cross-border financial activities in different occasions during the past couple of years, and he published an article that listed a number of forms of illegal cross-border financial services, including cross-border Bitcoin and ICO trading services. For the complete article, please see http://www.sfi.org.cn/news_detail/1409.html (Chinese only).

29 For example, on 17 June 2019, the Securities & Futures Commission of Hong Kong issued a circular reminding licensed corporations (LCs): (1) that under the PRC law, it is not legal for any unapproved institution to conduct foreign exchange margin trading in the PRC or for any client in the PRC to entrust an unapproved institution to do so; and (2) of the risks arising from LCs or their controlling entities and related corporations engaging in or being associated with illegal or fraudulent activities.

Recently, most platforms involved in virtual currency-related business activities have announced the cessation of business or restricted the services, or both, to be provided to customers in China, for instance:

- a* Huobi announced it would stop account registrations for new customers in China and close accounts for existing Chinese users by the end of 2021. For the remaining Chinese users who have not closed their account, account service fees are charged from 1 February 2022;³⁰
- b* on 26 September 2021, CoinBene announced the permanent shutdown of its business services in China, the functions for new users' registration, asset top-ups and coin borrowing will all be closed permanently for Chinese users;³¹
- c* OKEx has banned the access to Chinese users and removed its mobile application from app stores in China. According to OKEx's official announcement, OKEx will keep its 'exiting PRC market' policy and will not set up offices or teams in China;³² and
- d* in October 2021, Binance issued a notice providing that, in response to local government policies, Binance would be pulling the CNY trading area off the shelf by 31 December 2021 and from that date has been gradually ceasing its respective services to existing Chinese users.³³ Chinese users now are no longer able to gain access to or trade on Binance.

While in Hong Kong, a comprehensive licensing regime regulating virtual asset trading platforms (VATPs) has been formally established:

- a* in December 2022, significant amendments to the Anti-Money Laundering and Counterterrorist Financing Ordinance (AMLO) were passed by the Hong Kong government, which introduced a new licensing regime for virtual assets service providers;
- b* in 2023, the new regime was established by SFC via the issuance of a series of guidance, FAQs and handbooks and officially took effect on 1 June 2023 (the AMLO Regime); and
- c* under the AMLO regime, any person operating a VATP or marketing such services to the public in Hong Kong shall obtain a licence from the SFC, even for those who have or are applying for the Type 1 and Type 7 licences for dealing in STOs. The dual licensing regime is to avoid the contravention of the licensing regimes and to ensure business continuity given a virtual asset's classification may change when its terms and features evolve over time.³⁴

VI REGULATION OF MINERS

Before PRC regulators formally cracked down on virtual currency mining activities in 2021 by promulgating the VCM Circular, China was one of the largest Bitcoin mining hubs. According to the VCM Circular, virtual currency mining activities are characterised by significant energy consumption and carbon dioxide pollution with limited contribution to the growth of GDP and the advancement of industry and technology, and unregulated

30 See the news at <https://coingape.com/china-crypto-crackdown-exchanges-that-gave-in-to-the-regulators/>.

31 See the news at <https://www.cryptocnews.com/huobi-global-exiting-mainland-china/#:-:text=>.

32 See the news at <https://www.coinarp.com/exchange/announcement/okex-4411212179853-/>.

33 See the news at <https://new.qq.com/omn/20211013/20211013A0CWPU00.html> (Chinese only).

34 See the detailed licensing requirements on SFC's website at <https://www.sfc.hk/en/Welcome-to-the-Fintech-Contact-Point/Virtual-assets/Virtual-asset-trading-platforms-operators>.

growth, all of which would negatively affect the high-quality development of Chinese society, which does not align with China's strategic objectives of peak carbon emissions and carbon neutrality.

Different approaches are adopted by NDRC in the VCM Circular to regulate existing and new virtual currency mining activities.

i New virtual currency mining projects

NDRC has explicitly banned new virtual currency mining projects. 'Virtual currency mining activities' are listed as an 'obsolete industry' in the Catalogue for Guiding Industry Restructuring (2019); the PRC laws prohibit investments into obsolete industries.³⁵

Notably, the VCM Circular specifically bans mining activities conducted in the name of internet data centres. Furthermore, the VCM Circular states that 'virtual currency mining' should be clearly separated from blockchain, big data and cloud computing services. Local governments, financial institutions and payment firms are prohibited from providing financial support to new virtual currency mining projects. No new mining projects are allowed to be introduced into any industrial parks led by the local government.

Local governments are responsible for controlling and monitoring local energy consumption as required by NDRC, including the consumption from mining activities.

ii Existing virtual currency mining projects

Existing virtual currency mining projects are subject to an orderly phase out, for which the VCM Circular provides several restrictive measures to facilitate this process, which primarily include the following:

- a* illicit power supply to virtual currency mining projects provided by power plants (in particular small hydropower enterprises) are to be penalised;
- b* additional electricity charges should be imposed for electricity supplied to virtual currency mining projects;
- c* virtual currency mining projects are not allowed to enter the power market or to enjoy any benefits from the power market in any form;
- d* no financial or tax support is to be granted for virtual currency mining projects, and existing preferential policies with respect to taxes, lease rentals or water and electricity granted will cease within a certain time limit; and
- e* financial institutions or payment firms are not allowed to provide any financial services or credit support for virtual currency mining in any means, directly or indirectly. Measures will be taken to accelerate the recovery of existing loans.

After NDRC imposed the mining ban, local governments in popular virtual currency mining areas have actively taken steps to clean up virtual currency mining projects. For example, in

35 See Article 19 of the Interim Provisions on Promoting Industrial Structure Adjustment promulgated by the State Council on 2 December 2005 and effective from that date.

Inner Mongolia, all virtual currency mining projects were required by the Inner Mongolia NDRC to shut down by the end of April 2021³⁶ and, according to public information, 49 virtual currency mining projects were closed by June 2022.³⁷

VII REGULATION OF ISSUERS AND SPONSORS

According to the ICO Circular, issuing tokens to obtain financing from investors constitutes an unauthorised and illegal public financing activity. From the date of the ICO Circular, all types of token financing are explicitly banned. Issuers must make plans to exit from their existing token financing projects. No financial institutions or payment firms are allowed to provide services, directly or indirectly, for token issuances and financings, including account opening, registration, clearing and settlement. In addition, financial institutions and payment firms are obliged to report to the competent authorities if they find any illegal token financing activities.

Token issuances and financings are no longer allowed in China and no such licensing regime or regulatory requirement exists for issuers and sponsors to conduct such activities.

While not without risk, offshore token issuances and financings with a China nexus (such as the ultimate shareholder of an offshore investor being in China) are not the current focus of PRC regulators. However, administrative and technological measures will be adopted to minimise China nexus to the largest extent. Financiers and investors are suggested to conduct a comprehensive regulatory review before the formal commencement of any China-related token issuance or financing transactions.

VIII CRIMINAL AND CIVIL FRAUD AND ENFORCEMENT

The rules as provided in the Key Prohibition Rules are general in nature. Aiming to deter criminal offences involving virtual currencies, the SPC and the Supreme People's Procuratorate have jointed the 10 administrative departments that promulgated Circular No. 237. However, no specific law enforcement measures targeting virtual currency-related crimes are provided under Circular No. 237.

On 23 February 2022, the SPC promulgated the Decision on Amending the Interpretation of the Supreme People's Court on Several Issues Concerning the Specific Application of Law in the Trial of Criminal Cases of Illegal Fund Raising, which took effect from 1 March 2022. Virtual currency trading is explicitly enumerated as a method for illegal fundraising. However, it does not mean that all virtual currency trading activities will be deemed as illegal fundraising activities. To constitute an illegal fundraising activity, the following key elements need to be met:

- a* collecting public funds without the authorisation from the authorities or under the disguise of legitimate business forms;
- b* advertising to the public through means such as the internet, media, promotional events, flyers and mobile phone messages;

36 See Article 2(9) of Measures to Ensure the Achievement of the 14th Five-Year Plan's Double Control Target on Energy Consumption issued by NDRC.

37 See the news from Inner Mongolia Daily's website at: http://szb.northnews.cn/nmgrb/html/2022-06/09/content_36809_182820.htm (Chinese only).

- c* promising the return of principal with interest within a certain period to induce investors, in kind, cash or equity interests; and
- d* raising funds from the general public.

Individuals or entities that conduct illegal fundraising activities may be convicted of the crime of illegally collecting public funds,³⁸ and may also be convicted of criminal fundraising fraud if such activities are committed with the intent to unlawfully possess the funds.³⁹ In addition, using virtual currencies as a method to transfer funds generated from certain enumerated crimes⁴⁰ may constitute a crime of money laundering.⁴¹

Notably, the PRC Criminal Law can also be extraterritorially applied to crimes:

- a* committed by PRC citizens outside the territory of the PRC;⁴²
- b* committed by foreigners against the PRC or PRC citizens outside the territory of the PRC, if such offence is subject to a minimum three-year fixed-term imprisonment in accordance with the PRC Criminal Law;⁴³ and
- c* in accordance with international treaties and conventions.⁴⁴

The cross-border circulation of virtual currencies is swift and trading in virtual currencies is not easily traceable, leading to complexities in investigating virtual currency-related crimes. Chinese authorities have been enhancing their technical skills and processes in investigating virtual currency-related crimes. For example, in April 2022, the Suzhou Xiangcheng District Procuratorate issued the Guidelines for Investigating Crimes Involving Virtual Currencies, which provide detailed guidance on the entire investigation process of virtual currency-related crimes and introduces third-party technology companies to help with technical issues, such as to track the funds flow of virtual currencies.⁴⁵

IX TAX

Tax implications of trading virtual currencies are yet unclear under the PRC laws. There are no specific tax laws applicable to virtual currencies. Although the regulators tend to have limited tolerance towards the private holding and trading of virtual currencies as virtual commodities, such trading activities at the current stage are still discouraged according to the Key Prohibition Rules.

38 See Article 176 of the PRC Criminal Law.

39 See Article 192 of the PRC Criminal Law.

40 The upstream criminal activities for money laundering provided by the PRC Criminal Law include: (1) drug crimes; (2) crimes of mafia-style organisations; (3) terrorism; (4) smuggling; (5) corruption and bribery; (6) disruption of the financial regulatory order; and (7) financial fraud.

41 See Article 191 of the PRC Criminal Law.

42 See Article 7 of the PRC Criminal Law. However, if the maximum punishment to be imposed is fixed-term imprisonment of not more than three years, the individual may be exempted from the investigation for criminal liability.

43 See Article 8 of the PRC Criminal Law. However, it is not applicable to a crime that is not punishable according to the laws of the place where the crime committed.

44 See Article 9 of the PRC Criminal Law.

45 See the Guidelines for the Investigation of Virtual Currency Related Crimes published by the People's Procuratorate of Xiangcheng District, Suzhou, accessible at: http://www.jsjc.gov.cn/yaowen/202204/t20220426_1378772.shtml (Chinese only).

On 28 September 2008, SAT issued the Official Reply on Issues Concerning Individual Income Tax on Revenue from Trading Virtual Currency via the Internet (the Virtual Currency Tax Reply), according to which the income generated from buying and selling virtual currencies through the internet constitutes taxable income and is subject to personal income tax. The property value of the virtual currencies sold by any individual equals the aggregate amount of the purchase price of the virtual currencies paid by the seller and the related taxes. The competent tax authority should verify and determine the value of the virtual currencies if the seller fails to provide evidence of their original value. However, virtual currencies as regulated by the Virtual Currency Tax Reply refer to the in-game currencies, such as Q-coins designed by Tencent, which have gained popularity among buyers and sellers, and can be purchased using fiat currency. The Virtual Currency Tax Reply was not intended to apply to virtual currencies designed based on the blockchain technology (such as Bitcoin) as they had not been widely introduced into China when the Virtual Currency Tax Reply was issued by SAT.

X OTHER ISSUES

i E-CNY

E-CNY,⁴⁶ also known as the digital yuan or the Digital Currency Electronic Payment (DCEP), is a digitised version of China's legal currency, the yuan. Different from the other forms of virtual currencies, e-CNY is a fiat currency. In the table below, the key comparisons between e-CNY and other virtual currencies are shown.

	E-CNY	Other virtual currencies
Credit base	National credit endorsement	Digital algorithm or private commitment
Issuer	PBoC	Private entities
Underlying technology	Blockchain technology, distributed ledgers and asymmetric encryption authentication technology	Blockchain technology, distributed ledgers and asymmetric encryption authentication technology
Level of decentralisation	Centralised issuance and settlement, decentralised payment	Centralised issuance and decentralised payment and settlement
Asset reserves	Full payment of asset reserves supported by commercial institutions and PBoC	No physical assets reserves
Regulatory authority	PRC government	No centralised regulatory authority
Stability of currency value	Stable	Unstable

Nowadays, the general public in China is familiar with digital payments through mainstream electronic platforms such as Alipay (owned by Alibaba) and WeChat Pay (owned by Tencent), and the use of cash is declining. Amid the fast development of virtual currencies and stable coins, China has also started to explore new payment infrastructures to adapt to the needs of retail customers in the digital era.

Research on digital fiat currency was launched by PBoC in 2014. By the end of 2017, as approved by the State Council, research and development of e-CNY were officially put on

⁴⁶ Unless otherwise provided, the statistics and information provided in this Section X(i) are borrowed from the Progress of Research & Development of E-CNY in China issued by the Working Group on E-CNY Research and Development of PBoC in July 2021.

the agenda. At the end of 2019, PBoC launched pilot programmes in Shenzhen, Suzhou, Xiongan and Chengdu for the trial use of e-CNY and, in November 2020, the pilot areas were further expanded to include another six cities.⁴⁷ The pilot scheme was further expanded to cover 26 Chinese cities in 2023.⁴⁸ By the end of 30 June 2021, the number of e-CNY pilot application scenarios had exceeded 1.32 million, covering utility payment, care services, transportation, shopping and government services.

In addition, PBoC signed a memorandum of understanding with the Hong Kong Monetary Authority on Fintech Innovation and Regulation in the Great Bay Area to enhance the cooperation between governments in Central Bank Digital Currency (CBDC). According to PBoC, it also joined the Multiple CBDC Bridge (m-CBDC Bridge) led by the BIS Innovation Hub to explore the CBDC options with the BIS innovation centres in the Hong Kong Special Administrative Region and Singapore.⁴⁹

Under the DCEP system, PBoC will issue e-CNY to selected commercial banks⁵⁰ as authorised operators, which, together with other designated commercial institutions, will conduct the exchange and circulation of e-CNY to the public. PBoC has launched a mobile app allowing users to sign up and use e-CNY. This mobile app is expected to promote the trading volume of e-CNY.

Conditional anonymity is granted because the management on e-CNY follows the principle of ‘anonymity for small value and traceable for high value’, according to which users are allowed to make small transactions without disclosing their personal information. To better protect the users’ privacy, less transaction information is required to be disclosed for trading on the e-CNY app compared to traditional electronic payment system.

ii Non-fungible tokens

Non-fungible tokens (NFTs) are not prohibited in China, although they derive from the blockchain technology with inextricable links to virtual currencies. This is primarily because NFTs are distinguishable from currencies because of their non-homogenous nature. NFTs are usually referred to as ‘digital collectibles’ rather than ‘tokens’ in China to avoid being prohibited under the Key Prohibition Rules. Since 2021, many leading internet companies and venture capitalists have been actively engaging in the development and application of NFTs and its related products in art and gaming. In December 2021, the state media

47 These six cities are Shanghai, Hainan, Changsha, Xi’an, Qingdao and Dalian. See the news at: <http://finance.people.com.cn/n1/2022/0405/c1004-32391754.html> (Chinese only).

48 Users in the following 26 cities/areas in 17 provinces can sign up to use the e-CNY app: Beijing; Tianjin; Hebei Province; Dalian; Shanghai; Jiangsu Province; Zhejiang Province (only in Hangzhou, Ningbo, Wenzhou, Huzhou, Shaoxing and Jinhua); Fujian Province (only in Fuzhou and Xiamen); Shandong Province (only in Jinan and Qingdao); Changsha; Guangdong Province; Guangxi Province (only in Nanning and Fangcheng Port); Hainan Province; Chongqing; Sichuan Province; Yunnan Province (only in Kunming and Xishuangbanna); and Xi’an.

49 See the news on PBoC’s website at <http://www.pbc.gov.cn/en/3688110/3688175/4411249/index.html>.

50 As shown on the e-CNY mobile app, the commercial banks include: (1) Industrial and Commercial Bank of China; (2) Agricultural Bank of China; (3) Bank of China; (4) China Construction Bank; (5) Bank of Communications; (6) Postal Savings Bank of China; and (7) China Merchant’s Bank. The two online banks are WeBank (WeChat Pay) and MyBank (Alipay).

Xinhua News Agency released China's first digital news collection through blockchain NFT technology for selected photojournalism from 2021.⁵¹ However, the financial or speculative use of NFT is strictly prohibited.

On 13 April 2022, NIFA, CBA and the Securities Association of China jointly issued the Initiative on Preventing Financial Risks Related to NFTs (the NFT Initiative). While recognising the potential value of NFTs in promoting the development of China's culture and creativity industry, associations emphasised that the financing and securitisation of NFTs would be strictly prohibited and the following illegal activities, *inter alia*, would be included:

- a* issuing NFTs linked with financial assets;
- b* undermining the non-homogenous nature of NFTs for the purpose of ICO;
- c* providing centralised trading services for NFTs; and
- d* using virtual currencies, such as Bitcoin, Ethereum and TEDA, as the pricing and settlement methods for the issuance and trading of NFTs.

Although the NFT Initiative is not a normative legal document, it more or less reflects the current regulatory views and may be referenced by law enforcement.

NFTs are subject to a series of regulatory requirements under the Provisions on Administration of Blockchain-based Information Services, as they derive from blockchain technology. Under these provisions, NFT service providers (such as blockchain-based information service providers) are required to, among other things, complete filings with CAC within 10 business days from the commencement of their services and pass a CAC security assessment before releasing new products, applications or features.⁵²

XI LOOKING AHEAD

The Chinese government is committed to the gradual lifting of financial controls and promoting financial liberalisation. However, without establishing a regulatory regime to afford effective protections to investors and to safeguard China's financial system, PRC regulators have imposed a blanket ban on virtual currencies by promulgating the Key Prohibition Rules. In the short term, the trend that virtual currencies and virtual currency-related business activities are subject to a comprehensive control is expected to continue. For now, the regulatory focus is to prevent systemic financial risk and to deter virtual currency speculation and money-laundering activities. The licensing regime under AMLO established in Hong Kong may serve as a model for mainland China's policy formulation if it is operated successfully.

Nevertheless, China has embraced blockchain technology and continuing efforts are being put into financial innovation and digitalisation. The Draft Courts' Meeting Minutes and the Shanghai High People's Court have officially recognised virtual currencies' legal nature as virtual assets, contributing to the regulatory consistency toward virtual currencies and may have significant influence over subsequent court rulings in the PRC. The launch of the e-CNY, as opposed to legalising other forms of virtual currencies, manifests China's aim of establishing and strengthening its currency and the financial system while facilitating the implementation of effective monetary policies. There remains room for the growth of NFT business in China, provided that those businesses comply with the regulatory requirements.

51 See the news at <https://www.ccvalue.cn/article/1389474.html> (Chinese only).

52 See Articles 9 and 11 of the Administrative Provisions on Blockchain-Based Information Services.