

# SFC warns of cryptocurrency risks

9 Feb 2018

The Securities and Futures Commission (SFC) once again alerts investors to the potential risks of dealing with cryptocurrency exchanges and investing in initial coin offerings (ICOs). Following a statement on ICOs released on 5 September 2017 (Note 1), the SFC has taken regulatory action against a number of cryptocurrency exchanges and issuers of ICOs.

The SFC has sent letters to seven cryptocurrency exchanges in Hong Kong or with connections to Hong Kong (Note 2) warning them that they should not trade cryptocurrencies which are "securities" as defined in the Securities and Futures Ordinance (SFO) without a licence.

Most of these cryptocurrency exchanges either confirmed that they did not provide trading services for such cryptocurrencies or took immediate rectification measures, including removing relevant cryptocurrencies from their platforms. The SFC may take further action where appropriate, in particular against cryptocurrency exchanges which disregard the provisions of the SFO and those which are repeat offenders.

The SFC has also written to seven ICO issuers. Most of them confirmed compliance with the SFC's regulatory regime or immediately ceased to offer tokens to Hong Kong investors. The SFC will continue to closely monitor ICOs, and will not tolerate any violations of the securities laws of Hong Kong.

ICOs are essentially crowdfunding by blockchain start-ups. ICO issuers are typically assisted by market professionals such as lawyers, accountants and consultants for advice to structure the offering as utility tokens to fall outside the purview of the SFO and to circumvent the scrutiny of the SFC.

"We will continue to police the market and enforce when necessary," said Mr Ashley Alder, the SFC's Chief Executive Officer. "But we are also urging market professionals to do proper gatekeeping to prevent frauds or dubious fundraising and to assist us in ensuring compliance with the law."

Investors have complained to the SFC that they were unable to withdraw fiat currencies or cryptocurrencies from their accounts opened with cryptocurrency exchanges. Some complainants claimed that cryptocurrency exchanges had misappropriated their assets or manipulated the market, or that technical breakdowns of the exchanges' platforms caused them significant losses. Several complaints against ICO issuers alleged unlicensed or fraudulent activities.

"If investors cannot fully understand the risks of cryptocurrencies and ICOs or they are not prepared for a significant loss, they should not invest," said Ms Julia Leung, the SFC's Executive Director of Intermediaries. "Investors who store their fiat currencies and cryptocurrencies with unregulated cryptocurrency exchanges should be aware of the risks of hacking and misappropriation of assets."

Investors are also urged to be wary of the increased risk of extreme price volatility, hacking and fraud when investing in cryptocurrencies and ICOs, and using services of cryptocurrency exchanges. Where these occur in an online environment, victims may have difficulty pursuing action against cryptocurrency exchanges or fraudsters to recover losses.

The SFC may not have jurisdiction over cryptocurrency exchanges and ICO issuers if they have no nexus with Hong Kong or do not provide trading services for cryptocurrencies which are "securities" or "futures contracts". If, however, there is suspicion of fraud, the SFC is open to refer cases to the Police for investigation.

End

Notes:

1. The SFC's September statement explained the licensing and authorisation requirements when the arrangement of an ICO or the underlying cryptocurrency amounts to "securities" as defined under Part 1 of Schedule 1 to the SFO. The SFC also warned investors about the potential risks involved in ICOs and cryptocurrencies, such as fraud, insufficient liquidity and opaque pricing. In addition, a circular issued by the SFC on 11 December 2017 explained that an entity is required to have an appropriate licence or authorisation from the SFC if it provides any business services which relate to Bitcoin futures contracts or cryptocurrency-related investment products and constitute a "regulated activity" as defined in the SFO.
2. The SFC has noticed that, in terms of daily trading volume, a number of cryptocurrency exchanges in Hong Kong or which have connections with Hong Kong rank in the top 20 globally.

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