



**GBBC**  
Global Blockchain  
Business Council

INSIGHT REPORT

# **GLOBAL STANDARDS MAPPING INITIATIVE (GSMI) 2.0** STANDALONE REPORT

## **CRYPTO-DERIVATIVES: LEGAL AND REGULATORY MAPPING**

November 2021



*The GBBC would like to thank our many partners, members, and supporters who worked tirelessly and enthusiastically over the past months to produce this standalone report as a part of GSMI 2021, version 2.0.*

## **Contributors**

<b>Borsa Italiana</b>	Nicolas Bertrand (co-chair) Giacomo Spedini
<b>Latham &amp; Watkins</b>	Yvette Valdez (co-chair) Deric Behar Alex Dubose Adam Fovent Alex McKenzie Nicholas Steele
<b>Miami University Ohio</b>	Alex Stan (GSMI fellow)
<b>Cumberland DRW</b>	Andrew Ridenour
<b>Digital Asset</b>	Beth Sendra
<b>Digital Gold Institute</b>	Ferdinando Ametrano
<b>Diversifi</b>	Eitan Katz
<b>Eqonex</b>	Marieke van Kleef
<b>ErisX</b>	Matthew Trudeau
<b>Former Deloitte</b>	Alessia Di Noto
<b>Genesis Global Trading</b>	Garynn Noel Leon Kelly
<b>JPMorgan Chase &amp; Co.</b>	Yousuf Siddiqui
<b>Kaiko</b>	Ambre Soubiran Clara Medalie
<b>London Stock Exchange Group</b>	Kristen Mierzwa
<b>SIX Digital Exchange</b>	Peter T. Golder Niamh Lane

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## Introduction

The Global Standards Mapping Initiative (GSMI) 2.0 is a continuation of the crypto and blockchain regulatory and technical mapping work which was released in October 2020. The open access, community-sourced, initiative includes over 100 public and private sector institutions, and over 200 individuals who have devoted many hours of research, discussion, writing and editing to produce GSMI 2.0 and its constellation of subtopic reports.

The GSMI 2.0 Derivatives Working Group, formed in 2021, has researched and mapped a subset of twelve key jurisdictions which are paving the way for the development and growth of crypto-derivatives. Our initial regulatory mapping report provides key insights into derivatives specific regulatory considerations and as the crypto-derivatives markets evolve, we expect to update and further expand this body of work. We welcome feedback and comments to [gsmi2021@gbbcouncil.org](mailto:gsmi2021@gbbcouncil.org).

## North America

### United States

#### *Introduction*

The regulatory landscape for crypto-derivatives and other financial instruments providing synthetic exposure to crypto-assets continues to evolve in the United States and implicates the regulatory perimeters of multiple regulators. At the federal level, both the Commodity Futures Trading Commission (“CFTC”) and the Securities and Exchange Commission (“SEC”) have demonstrated ongoing interest and activity with respect to the application of their respective regulations to crypto-derivatives and other financial instruments providing synthetic exposure to crypto-assets. As explored in more detail below, the experience in the United States to date provides a clear example of both (a) the ways in which existing regulations can apply and are being applied and enforced with respect to crypto-derivatives transactions, intermediaries, and platforms; and (b) the tensions in applying existing approaches to regulation, which typically presuppose the regulation of identifiable intermediaries, to crypto-derivatives transactions and platforms which seek to operate in a decentralized or disintermediated fashion.

## ***CFTC Regulation of Crypto-Derivatives***

The CFTC emerged as one of the principal regulators of crypto-derivatives in the United States. Although originally concerned primarily with the regulation of exchange traded futures on agricultural commodities, the CFTC's current regulatory authority under the Commodity Exchange Act ("CEA") extends to futures, options, leveraged or margined contracts offered to retail participants, and/or swap contracts (collectively, "Commodity Interests") on "commodities" - a term of incredibly broad import. In addition to the CFTC's plenary authority with respect Commodity Interest transactions and intermediaries involved therewith, the CFTC also has anti-fraud and anti-manipulation enforcement authority with respect to spot commodity markets. The evolving market for crypto-derivatives implicates each of these different aspects of the CFTC's regulatory and enforcement authority.

### ***Crypto-Assets as Commodities***

The identification of a relevant "commodity" is a fundamental determinant of the CFTC's regulatory authority with respect to a particular transaction or type of transaction. The statutory definition of a "commodity" under the CEA includes an enumerated list of agricultural commodities but also, subject to two limited exceptions,<sup>1</sup> "all other goods and articles . . . and all services, rights, and interests . . . in which contracts for future delivery are presently or in the future dealt in."<sup>2</sup>

The CFTC has stated on multiple occasions, and judicial decisions involving CFTC enforcement actions have confirmed, that crypto-assets (including Bitcoin and Ether) constitute "commodities" for purposes of the CEA and the regulations promulgated by the CFTC thereunder ("CFTC Rules"). As early as 2014, then-CFTC Chairman Timothy Massad observed in congressional testimony before the Senate Committee on Agriculture, Nutrition, and Forestry that what the CFTC has referred to as "virtual currencies" are "commodities" for purposes of the CEA and CFTC Rules<sup>3</sup> The CFTC first asserted this view in an enforcement action in 2015,<sup>4</sup> and the position that crypto-assets are "commodities" has now been taken in a range of CFTC enforcement actions<sup>5</sup> and related judicial decisions.<sup>6</sup>

### ***Crypto-Derivatives as Futures and Options on Futures***

Throughout much of its history, the CFTC's primary regulatory focus was on futures contracts. The CEA itself does not define or employ the term "futures contract," instead referring to "contracts of sale of a commodity for future delivery."<sup>7</sup> However, the generally accepted meaning of a futures contract in the CEA context is a standardized, exchange-traded forward contract that provides for the purchase or sale of an underlying commodity at

a fixed price for delivery and payment at a later date, or the cash settlement thereof.<sup>8</sup> While the determination of whether a particular instrument constitutes a futures contract entails a holistic facts-and-circumstances inquiry, the CFTC and federal courts have identified certain indicia of a futures contract, including:<sup>9</sup>

- Standardization of terms (i.e., contract terms are not negotiable as between the parties, and must be accepted by both parties), other than price (which is established by market demand);
- Most parties may not expect to take delivery of the underlying commodity;
- Contract provides an opportunity to offset, and customer has the ability to liquidate (i.e., cash settle or sell) rather than take physical delivery;
- Ability of customer to take a long (i.e., buyer) or short (i.e., seller) position on a specified quantity of the underlying commodity;
- Provides customer with the ability to control or secure their position in the contract with a partial deposit (i.e., margin, collateral);
- Customer does not acquire a specific right to a particular lot of the underlying commodity; and
- The instrument is offered to the general public.

As crypto-assets constitute commodities for purposes of the CEA, crypto-derivative products meeting this description are subject to regulation as futures contracts.

With limited exceptions, commodity futures (and options on commodity futures) may only lawfully be traded on or subject to the rules of a regulated futures exchange. Within the United States, any exchange that wishes to offer trading in futures, including crypto-derivatives that constitute futures, must have been designated by the CFTC as a contract market (i.e., must be a designated contract market or “DCM”) and must comply with the CFTC Rules applicable to DCMs, including requirements that all futures contracts be cleared with a registered derivatives clearing organization (“DCO”)<sup>10</sup>. In addition, exchanges located outside the United States may only lawfully offer futures contracts to U.S. customers by registering with the CFTC as a foreign board of trade (“FBOT”). Furthermore, intermediaries that engage in certain activities in relation to futures and options on futures must, depending on the nature of the activities they engage in, register with the CFTC as a futures commission merchant (“FCM”), introducing broker (“IB”), commodity trading advisor (“CTA”), or commodity pool operator (“CPO”), as applicable.

In order to list a particular contract for trading, DCMs must either complete a self-certification process or make a submission to the CFTC for review and approval. When a DCM self-

certifies a new contract it must determine that the offering complies with certain requirements under the CEA and CFTC Rules, including the requirement that the new contract is not readily susceptible to manipulation. A few CFTC registered DCMs have listed crypto-asset futures contracts and options thereon since 2017, including Bitcoin futures, options on Bitcoin futures, and Ether futures. These include products that are cash-settled as well as products that involve delivery of crypto to satisfy the contract.

### ***Crypto-Derivatives as Swaps***

As part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the CFTC's regulatory authority under the CEA was expanded to bilateral, over-the-counter derivatives or "swaps." The definition of a "swap" under the CEA and CFTC Rules is incredibly broad, and captures any agreement, contract, or transaction that derives its value from the value, level, or changes "in one or more interest rates, other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind."<sup>11</sup> The breadth of this definition means that crypto-derivatives which, by definition in some way derive their value or pricing from the value of a crypto-asset or other underlying, will generally constitute "swaps" under the CEA, absent an applicable exception or exclusion (e.g., for products that are regulated as futures).

Crypto-derivatives that constitute "swaps" may only lawfully be entered into between sophisticated counterparties that qualify as eligible contract participants ("ECPs") under the CEA and CFTC Rules.<sup>12</sup> The threshold to qualify as ECP is relatively high, and for individuals requires aggregate amounts of more than USD \$10 million invested on a discretionary basis (or USD \$5 million if using swaps for hedging purposes).<sup>13</sup>

In addition, the CEA and CFTC Rules impose a range of regulatory requirements on swaps and participants and intermediaries involved in swaps. For example, persons that engage in swap dealing activity above certain *de minimis* thresholds must register with the CFTC as swap dealers ("SDs"), and persons with substantial swap exposure must register with the CFTC as major swap participants ("MSPs"). SDs and MSPs are subject to an extensive regulatory regime, including business conduct standards and margin, capital, and clearing requirements. Furthermore, any trading system or platform that provides more than one market participant the ability to execute or trade swaps with more than one other market participant on the system or platform must register with the CFTC as a swap execution facility ("SEF") or be designated as a DCM operating under the regulatory oversight of the CFTC. In addition, the CFTC has the authority to designate certain types of swaps for mandatory clearing by a registered derivatives clearing organization ("DCO"), which

transactions generally also be executed on a trading facility that is registered with the CFTC as a SEF or DCM. Additionally, all swap transactions must be reported to a CFTC registered swap data repository (“SDR”).

The CEA also grants the CFTC plenary authority with respect to “commodity options” (excluding options on a security or on any group or index of securities).<sup>14</sup> Accordingly, options on crypto-assets are subject to regulation by the CFTC. Subject to a limited exemption for “trade options” (i.e. options to physically deliver an exempt or agricultural commodity that involve on at least one side “a producer, processor, or commercial user” or merchant in the commodity), commodity options are subject to the same CFTC swaps regulatory regime set out above.<sup>15</sup> Indeed, one of the CFTC’s first crypto-asset related enforcement actions concerned the offering of trading in Bitcoin option contracts without registration as a SEF or DCM.<sup>16</sup>

### ***Retail Leveraged Commodity Transactions***

In addition to its regulatory authority with respect to futures and swaps, the CFTC has regulatory authority with respect to retail leveraged, margined, or financed purchases of commodities not resulting in “actual delivery” of the relevant commodity within 28 days. Absent meeting the actual delivery exception, such transactions with retail customers (i.e., non-eligible contract participants) are subject to regulation *as if* they were futures contracts (and thus subject to the requirements and prohibitions discussed above).

Crypto markets have seen increasing use of leverage and margin for trading, and the application of the Retail Commodity Transaction rules to crypto-asset markets has emerged as an area of CFTC enforcement focus. Furthermore, in 2020, the CFTC finalized interpretive guidance on what constitutes “actual delivery” in the context of crypto-assets which serve as a medium of exchange.<sup>17</sup>

### ***Emerging Focus on DeFi***

The application of the foregoing CFTC regulatory regimes to crypto-derivatives poses ongoing conceptual challenges particularly in relation to the application of traditional intermediary-focused regulatory approaches to the decentralized and disintermediated nature and goals of many DeFi projects.

On June 8, 2021, CFTC Commissioner Dan M. Berkovitz gave a speech that provided a stern reminder that existing regulatory requirements under the CEA, including the DCM and SEF registration requirements discussed above, currently apply to DeFi markets and



platforms.<sup>18</sup> Indeed, Commissioner Berkovitz specifically remarked that he did not see how unregistered DeFi markets for derivatives instruments are legal under the CEA, and cautioned that the CEA does not contain any registration exceptions for smart contracts and DeFi applications. That is, under the CEA and CFTC Rules, a decentralized trading market or platform offering crypto-derivatives without appropriate registrations or otherwise in compliance with the regulatory regimes discussed above would be in violation of U.S. law.

### ***Lingering Questions about Stablecoins***

There are lingering questions about the regulatory status of stable-coins in light of the broad definition of a “swap” set out above. By their very design, stablecoins seek to link or peg their (stable) value to some underlying - whether a particular unit or basket of fiat currency, precious metals or other commodities, or an algorithmic metric of some kind. Accordingly, there is a potentially argument that stablecoins fall within the broad definition of a “swap” under the CEA and CFTC Rules in that they derive their value from some underlying.

This question was brought into focus in November 2019 when then-CFTC Chairman Heath Tarbert commented that Facebook’s Libra, which was proposed as a stablecoin based on a basket of major currencies, was “a fundamentally different product” to Bitcoin and noted the way “it is structured, linking it directly to a set of national currencies.”<sup>19</sup> While to date there have been no statements by the CFTC or CFTC Staff or enforcement actions confirming or advertizing to the potential characterization of stablecoins as “swaps,” uncertainty remains as to whether such a position could be taken in the future.

### **SEC Regulation of Crypto-Derivatives**

While the CFTC is often viewed as the principal regulator of derivatives in the United States, regulatory authority with respect to certain categories of derivatives - security futures, options on securities, and security-based swaps - is allocated to the SEC (or shared between the CFTC and the SEC). The evolving market for crypto-derivatives implicates each of these different aspects of the SEC’s jurisdiction and authority.

### ***Crypto-Derivatives as Security Based Swaps***

The CFTC and the SEC have jointly adopted regulations defining “security-based swaps,” which include swaps based on single securities and narrow-based indices of securities. If a crypto-asset is deemed to be a security, then derivatives transactions referencing that crypto asset may constitute a security-based swap. Similarly, a crypto-asset or crypto-derivative transaction that is based on, references, or derives its value from a particular security or

narrow index of securities, whether or not such securities are themselves crypto assets, will generally constitute a security-based swap.

Indeed, on July 21, 2021 in remarks before the American Bar Association Derivatives and Futures Law Committee, SEC Chair Gary Gensler addressed the intersection of the SEC's security-based swaps regulatory regime with emerging financial technologies such as crypto-assets and other products that are priced off of the value of securities and operate like derivatives.<sup>20</sup> Chair Gensler emphatically stated that platforms offering security-based swaps — whether in the decentralized or centralized finance space — implicate the U.S. federal securities laws and must comply with the SEC's security-based swap regime, specifically referencing as examples “a stock token, a stable value token backed by securities, or any other virtual product that provides synthetic exposure to underlying securities.”

As with swaps, security-based swap transactions and participants and intermediaries therein are subject to a range of regulatory requirements. In particular, the Securities Act makes it unlawful to offer or sell a security-based swap to any person who is not an ECP unless a registration statement is in effect with respect to such security-based swap.<sup>21</sup> Indeed, in July 2020, the SEC and CFTC brought a joint enforcement action against a crypto-currency app developer for offering crypto-collateralized contracts providing synthetic exposure to stocks and shares in exchange traded funds to non-ECPs without an effective registration statement.<sup>22</sup>

Similar to the swaps regulatory regime, persons that engage in security-based swap dealing activity above certain *de minimis* thresholds must register with the SEC as security-based swap dealers (“SBSDs”), and persons with substantial swap exposure must register with the SEC as major security-based swap participants (“MSBSPs”). Like their swap counterparts, SBSDs and MSBSPs are subject to an extensive regulatory regime, including business conduct standards and margin, capital, and clearing requirements. Any trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility is required to register as a security-based swap execution facility (“SBSEF”). Furthermore, security-based swap transactions must be reported to a registered security-based swap data repository (“SBSDR”).

### ***Crypto-Derivatives as Security Futures***

Regulatory authority with respect to security futures and options on security futures with respect to single stocks or narrow-based security indexes is shared between the CFTC and the SEC.<sup>23</sup> As with futures generally, security futures products and options thereon are standardized, exchange traded contracts to buy or sell the relevant underlying for delivery in the future at a specific price. A crypto-derivative based on the future delivery (even if not ultimately physically delivered) of a single security or narrow index of securities would thus be subject to regulation as a security futures product. In contrast, futures products on broad-based security index futures are subject to regulation by the CFTC as discussed above.

CFTC regulated DCMs seeking to offer trading in security futures products must make a notice registration with the SEC and comply with certain requirements of the Securities Exchange Act of 1934.<sup>24</sup> Likewise, SEC-regulated national securities exchanges and national securities associations may trade security futures products if they complete a notice registration process with the CFTC and comply with certain requirements of the Commodity Exchange Act (CEA).

## **Other Forms of Synthetic Exposure to Crypto-Assets**

### ***Exchange Traded Funds***

At the time of publication, the U.S. approved the first set of exchange traded funds (“ETFs”) providing exposure to a crypto asset or crypto-assets, including ProShares and Valkyrie Bitcoin ETFs based on CME underlying BTC Futures contracts, not Bitcoin spot. Although a number of crypto-asset ETFs have applied to the SEC for regulatory approval since 2017, the first SEC regulated BTC ETF listed on October 19, 2021 under ticker BITO from Proshares. More BTC listings are expected to come to the US ETF markets over the coming weeks. In the U.S., ETFs must obtain SEC approval orders under the Investment Company Act of 1940 to allow exchange trading of their units throughout the day based on market prices and because of the creation and redemption process employed by ETFs. In previous years, delaying approval and/or rejecting applications for these orders in respect of proposed crypto-asset ETFs, the SEC had indicated its concerns about the susceptibility of crypto-asset markets to manipulation.<sup>25</sup>

On August 3, 2021, in remarks before the Aspen Security Forum SEC Chair Gary Gensler discussed investment vehicles providing exposure to crypto assets and indicated that he looks forward to the SEC’s Staff’s review of Bitcoin ETF filings, particularly if such funds are limited to holding CME-traded Bitcoin futures.<sup>26</sup> Accordingly, the recent BTC ETF listings on BTC futures, confirm that the SEC is prioritizing review of applications for ETFs providing

exposure to crypto-assets through the holding of futures contracts - rather than the underlying spot crypto-assets.

### ***Private Funds***

Further, there are a number of private investment funds that have been established to provide exposure to different crypto-assets, including Bitcoin, Ether, and various other digital assets. To date, these funds have operated pursuant to exemptions from the securities registration requirements of the Securities Act of 1933, and are thus generally only available to “accredited investors.” The most well-known of these funds is the Grayscale Bitcoin Trust, which has recently filed an application to the SEC to convert its Bitcoin Trust into an ETF.

## Canada

### Overview

Until a comprehensive crypto-derivative regulation is established, Canada is operating with an interim approach under its existing securities regulations.

On March 29, 2021, the Canadian Securities Administrators (“CSA”) and the Investment Industry Regulatory Organization of Canada (“IIROC” and, together, “Regulators”) published updated guidance on how securities law requirements apply to crypto asset trading platforms (“CTPs”), and how they may be tailored by regulators to the CTPs business models.<sup>27</sup> The applicable securities legislation includes both securities and derivatives, as well as the CTPs that facilitate their trading.<sup>28</sup>

### Application of Securities Legislation to CTPs

While CTPs may not believe they are subject to securities legislation because “they only allow for transactions involving crypto assets that are not in and of themselves, derivatives or securities,” the Regulators note that many CTPs merely provide their users with a contractual right or claim to an underlying crypto asset, rather than immediately delivering the crypto asset to its users.<sup>29</sup> The Regulators have concluded that these CTPs are generally subject to securities legislation.<sup>30</sup>

If a CTP trades in crypto assets that attach certain properties such as voting rights or rights to receive dividends, those assets will likely trigger securities regulation as they are already defined as securities.<sup>31</sup> Additionally, if a CTP retains a purchaser’s crypto assets internally, such as through a virtual wallet, instead of making immediate delivery of an asset, those assets will likely be treated as securities by the Regulators.<sup>32</sup>

However, when a crypto asset has been immediately delivered to a CTP’s users, the CTP may not be subject to the securities laws.<sup>33</sup> The Regulators generally will consider immediate delivery to have occurred if:

- the CTP immediately transfers ownership, possession and control of the crypto asset to the CTP’s user, and as a result the user is free to use, or otherwise deal with, the crypto asset without
  - further involvement with, or reliance on the CTP or its affiliates, and
  - the CTP or any affiliate retaining any security interest<sup>34</sup> or any other legal right to the crypto asset; and

- following the immediate delivery of the crypto asset, the CTP's user is not exposed to insolvency risk (credit risk), fraud risk, performance risk or proficiency risk on the part of the CTP

This guidance is largely consistent with the CFTC's interpretation of "actual delivery" with differences to account for the specific limitations on jurisdiction within the *U.S. Commodity Exchange Act*.<sup>35</sup>

### **Marketplace and Dealer Platforms**

The Regulators differentiate between (i) CTPs that operate as marketplaces bringing together multiple orders of buyers and sellers of securities and derivatives using established methods facilitate trades ("Marketplace Platforms"), and (ii) CTPs that facilitate the primary distribution of crypto securities or are otherwise the counterparty to the trades conducted on the platform ("Dealer Platforms").

Depending on the CTP's product offerings it will have to comply with the registration and reporting requirements required by the Regulators under the existing securities regulation.<sup>36</sup> The Regulators also contemplate instances where a Dealer Platform conducts marketplace activities that subject it to the regulatory framework applicable to Marketplace Platforms and vice versa.<sup>37</sup>

However, the Regulators have carved out interim approaches applicable to both Platforms wherein they may seek registration under an exempt status so long as leverage or margin products are not offered.<sup>38</sup>

### **Additional Considerations**

A CTP that also performs clearing functions may be considered a clearing agency or a clearing house under securities legislation.<sup>39</sup> In some jurisdictions:

- a registered dealer or recognized exchange is exempt from clearing agency recognition as dealers and exchanges are excluded from the definition of clearing agency
- the CTP is exempt from clearing agency recognition if the clearing functions are only an incidental component of its principal business, or
- the CTP may require recognition or need to seek an exemption from recognition as a clearing agency or a clearing house.

The Regulators have acknowledged that there are stablecoin-specific risks, and will consider them when determining the appropriate clearing and settlement requirements that should apply to CTPs.<sup>40</sup>

# European Union and the United Kingdom

## The United Kingdom

### Overview and authorization requirement

#### *The general prohibition*

The UK financial regulatory framework (“the UK regime”) contains a general prohibition on carrying on a regulated activity in the UK, or purporting to do so, unless a person is either authorised or exempt. Given this general prohibition, if an activity counts as a regulated activity a person will generally need to be authorised before carrying out the activity.

An activity is generally a regulated activity if it is: (i) an activity of a specified kind; (ii) which relates to an investment of a specified kind; and (iii) which is carried on by way of business. The relevant categories of “specified activity” and “specified investment” are set out in exhaustive fashion in UK legislation in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) (“RAO”).

#### *Specified investments – derivatives*

There are three categories of specified investment that amount to derivatives for the purposes of the UK regime: (i) options; (ii) futures; and (iii) contracts for differences.

Accordingly, in determining whether or not a particular instrument amounts to a derivative for the purposes of the UK regime it is sufficient to analyse whether or not it is captured by the definition of any of these three categories of specified investment. Such an analysis will turn on the rights and obligations that the instrument in question gives rise to, since the definitions of the various categories of specified investment are drawn by reference to the rights and obligations that characterise each category.

##### (i) *Options*

This category of specified investment captures options to acquire or dispose of certain kinds of underlying asset. Accordingly, irrespective of the underlying asset in question, in order for an instrument to fall within this category it must confer on the holder the right but not the obligation to acquire or dispose of some underlying property.

If an instrument does confer such an option, it will then be necessary to consider whether or not the underlying asset to which the option relates is of a kind that brings the option within the definition of this category of specified investment. In particular,



the definition captures options over securities (including cryptoassets that constitute securities for the purposes of the UK regime), certain contracts of insurance, other derivative contracts (including options over options where the underlying option is a regulated option), the currency of any country or territory (such as GBP, USD, etc., but not privately issued stablecoins referencing or representing such currencies) and certain precious metals (specifically, palladium, platinum, gold or silver).

With respect to options over underlying assets (including cryptoassets) not captured by the foregoing, such contracts may not be regulated although it would be necessary to consider whether or not they are caught by the various complex MiFID II definitions of derivatives and are contracts in relation which certain regulated entities are providing investment services and activities.<sup>41</sup>

(ii) *Futures*

This category of specified investment captures: (i) rights under a contract for the sale of a commodity or property of any other description under which delivery is to be made at a future date and at a price agreed on when the contract is made (where the contract is made for investment and not commercial purposes); and (ii) futures or forwards over commodities or currencies, or which are caught by the MiFID II concept of C(10) derivatives, that are not caught by (i), may be physically settled and in relation to which certain regulated entities are providing investment services and activities.<sup>42</sup>

There is an important exclusion from this category of specified investment for certain contracts that are made for commercial and not investment purposes. The RAO sets out in detail various factors that determine or indicate whether a contract is made for commercial or for investment purposes, but in summary:

- A contract is to be regarded as made for investment purposes if it is made or traded on a recognised investment exchange, or is made otherwise than on a recognised investment exchange but is expressed to be as traded on such an exchange or on the same terms as those on which an equivalent contract would be made on such an exchange.
- A contract not falling within the preceding bullet point is to be regarded as made for commercial purposes if under the terms of the contract delivery is to be made within seven days, unless it can be shown that there existed an understanding that (notwithstanding the express terms of the contract) delivery would not be made within seven days.

- The following are indications that a contract not falling within either of the preceding bullet points is made for commercial purposes and the absence of them is an indication that it is made for investment purposes: (i) one or more of the parties is a producer of the commodity or other property, or uses it in his business; (ii) the seller delivers or intends to deliver the property or the purchaser takes or intends to take delivery of it.
- It is an indication that a contract is made for commercial purposes that the prices, the lot, the delivery date or other terms are determined by the parties for the purposes of the particular contract and not by reference (or not solely by reference) to regularly published prices, to standard lots or delivery dates or to standard terms.
- The following are indications that a contract is made for investment purposes: (i) it is expressed to be as traded on an investment exchange; (ii) performance of the contract is ensured by an investment exchange or a clearing house; (iii) there are arrangements for the payment or provision of margin.

(iii) *Contracts for differences*

This category of specified investment captures a "(a) contract for differences; or (b) any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in – (i) the value or price of property of any description; or (ii) an index or other factor designated for that purpose in the contract".

There is an important exclusion from this category of specified investment for contracts under which the parties intend that the profit is to be secured or the loss is to be avoided by one or more of the parties taking delivery of any property to which the contract relates. This category of specified investment therefore applies only to contracts that are intended to be cash settled.

***Derivatives referencing cryptoassets versus “tokenised derivatives”***

With respect to cryptoassets, there are two principal ways in which the categories of derivatives under the UK regime may be applicable.

The first is in relation to derivative contracts that reference one or more cryptoassets as the underlying. With the notable exception of options, the categories of derivatives under the UK regime are defined by reference to underlying “property of any description”, meaning that the

definitions are broad enough to capture contracts which reference cryptoassets, regardless of whether or not those underlying cryptoassets are themselves regulated instruments.

The second is in relation to cryptoassets that confer rights and obligations that would bring them within the definition of one of the categories of derivatives under the UK regime – for example, a token that gives the holder the right but not the obligation to acquire an amount of gold or a tokenised version of a contract for difference in relation to any underlying. Such “tokenised derivatives” would amount to derivatives for the purposes of the UK regime, regardless of the fact that they are themselves cryptoassets.

### ***Specified activities most relevant to derivatives***

As discussed above, for an activity to be a regulated activity for the purposes of the UK regime it generally needs to be a specified activity undertaken by way of business in relation to a specified investment (and the exceptions to this general rule are not relevant for present purposes). It therefore follows that not all activities in relation to derivatives will constitute regulated activities for the purposes of the UK regime; only specified activities undertaken in relation to derivatives by way of business are capable of amounting to regulated activities.

The categories of specified activities most relevant to derivatives under the UK regime are: (i) dealing (as principal or as agent); (ii) arranging; (iii) operating a trading venue; (iv) discretionary management; and (v) advising.

#### *(i) Dealing (as principal or agent)*

There are two categories of specified activity under the UK regime which capture persons dealing in derivatives.

The first is the specified activity of dealing as principal, which captures a person who enters into a derivative contract as principal. However, there are important exclusions from this category of specified activity which have the effect that an unauthorised person will not be regarded as dealing as principal by entering into a derivative (other than a commodity derivative, for which other exclusions exist) with or through an authorised person (such as an investment firm or a bank), provided that the unauthorised person deals on an exclusively proprietary basis for its own account and certain other conditions are satisfied.<sup>43</sup> This means that true proprietary trading in derivatives with or through authorised persons ordinarily does not amount to a regulated activity requiring authorisation under the UK regime.

The second is the specified activity of dealing as agent, which captures a person who enters into a derivative contract as agent for another person.

(ii) *Arranging*

This category of specified activity captures persons who arrange deals in particular derivatives or make arrangements with a view to deals in derivatives taking place between persons who participate in the arrangements. Notably, operating an exchange for trading in derivatives is excluded from this category of specified activity, but is caught instead by the specified activities relating to operating a trading venue (see below).

(iii) *Operating a trading venue*

The categories of specified activities relating to operating a trading venue capture persons who operate either multilateral trading facilities or organised trading facilities (which are exchanges on which financial instruments (including derivatives) may be traded).

(iv) *Discretionary management*

This category of specified activity captures persons who exercise discretion when providing portfolio management services for individual client accounts, where the client's portfolio may include specified investments (including, for example, derivatives). Depending on their structure, this activity may be relevant to certain "copy trading" offerings (for example, if customers authorise the provider of the offering to execute trades for their accounts based on the service provider's discretion).

(v) *Advising*

This category of specified activity captures persons who provide investment advice in relation to derivatives. Again, depending on their structure, this activity may be relevant to certain copy trading offerings (for example, if customers are provided with recommendations to execute particular trades by the service provider or through the relevant platform).

### **Retail ban on derivatives referencing cryptoassets**

UK authorised investment firms are currently banned from marketing, distributing or selling "cryptoasset derivatives" (and cryptoasset exchange-traded notes) to retail customers in or from the UK.

For these purposes, a cryptoasset derivative is defined as a derivative (i.e., an option, future or contract for differences) in respect of which the underlying is or includes: (i) an “unregulated transferable cryptoasset”; or (ii) an index or derivative relating to an unregulated transferable cryptoasset.

In turn, an unregulated transferable cryptoasset is defined so as to capture only those cryptoassets that are transferable, are not pure utility tokens (i.e., tokens limited to being transferred to their issuer in exchange for a good or service, or to an operator of a network that facilitates their exchange for a good or service), are not regulated instruments (such as securities or electronic money), are not a representation of ownership or other property right in a commodity and are not money issued by a central bank.

## **Cryptoasset regulation**

### ***UK anti-money laundering (“AML”) regime***

The UK AML regime applies specifically to two types of cryptoasset business: (i) “cryptoasset exchange providers”; and (ii) “custodian wallet providers”. These terms are defined as follows:

“cryptoasset exchange provider” means a firm or sole practitioner who by way of business provides one or more of the following services, including where the firm or sole practitioner does so as creator or issuer of any of the cryptoassets involved, when providing such services—

- (a) exchanging, or arranging or making arrangements with a view to the exchange of, cryptoassets for money or money for cryptoassets,
- (b) exchanging, or arranging or making arrangements with a view to the exchange of, one cryptoasset for another, or
- (c) operating a machine which utilises automated processes to exchange cryptoassets for money or money for cryptoassets.”

“custodian wallet provider” means a firm or sole practitioner who by way of business provides services to safeguard, or to safeguard and administer—

- (a) cryptoassets on behalf of its customers, or
- (b) private cryptographic keys on behalf of its customers in order to hold, store and transfer cryptoassets, when providing such services.”

In turn, a “cryptoasset” is defined for these purposes as “a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can be transferred, stored or traded electronically”. Furthermore, for the purposes of limbs (a) to (c) of the definition of cryptoasset exchange provider, a reference to a cryptoasset includes “a right to, or interest in, the cryptoasset”.

With respect to these definitions, the following points are worth noting insofar as derivatives are concerned:

- The definition of cryptoasset is broad, and so would capture tokenised derivatives. However, it would not capture an ordinary derivative which simply references a cryptoasset as the underlying.
- True proprietary trading in cryptoassets for one’s own account is unlikely to be captured by the definition.
- Providers of software may be caught depending on the precise nature of their activities in relation to cryptoassets, however providers of non-custodial wallet software will not be captured by the definition of custodian wallet provider.

Businesses that fall within the definition of either a cryptoasset exchange provider or custodian wallet provider must register with the UK Financial Conduct Authority (“**FCA**”) as such prior to commencing relevant cryptoasset business. This registration requirement applies even if the business is already supervised by the FCA (for example, as an investment firm or a payment service provider). Cryptoasset exchange providers and custodian wallet providers must also conduct their business in accordance with the various requirements imposed by the UK AML regime (including, for example, customer due diligence requirements, ongoing monitoring and reporting requirements and organisational requirements).

## The European Union

In the European Union, regulators have framed their approach to the regulation of crypto derivatives based upon the complexity of crypto-derivative products as well as investor's lack of understanding regarding the risks that come with these products. The EU, through several of its regulatory bodies, has issued guidelines and calls for evidence to better regulate this issue, but individual EU member countries have also developed their own approaches.<sup>44</sup>

### A. ESMA & Market Supervision in the European Union

The European System of Financial Supervision (ESFS), the framework for financial supervision in the European Union, is made up of the European Supervisory Authorities (ESAs), the European Systemic Risk Board, the Joint Committee of the European Supervisory Authorities, and the national supervisory authorities of EU member states.<sup>45</sup>

Within the ESFS, there are three European Supervisory Authorities, who are directly responsible for supervision of the European Financial Markets: the European Banking Authority (EBA); the European Securities and Markets Authority (ESMA); and The European Insurance and Occupational Pensions Authority (EIOPA).<sup>46</sup> Each of the three ESAs has the power to issue non-legally binding Guidelines as tools to promote the consistent application of EU law across EU member states.<sup>47</sup>

ESMA is the independent market supervisory and enforcement authority within the EU responsible for promoting "consistent application of market rules".<sup>48</sup> ESMA has three objectives; to protect investors, maintain orderly markets and uphold financial stability within the European financial markets.<sup>49</sup>

### B. ESMA's View of Cryptocurrency and Crypto-derivatives

Most prominently as it pertains to cryptocurrency, crypto derivatives, virtual currencies and new financial instruments, EMSA has been granted specific product intervention powers to temporarily prohibit or restrict the marketing, distribution or sale of a financial instrument or a type of financial activity or practice when certain conditions are met.<sup>50</sup>

#### a. MiFID and MiFir

On October 20, 2011, the European Commission adopted a legislative proposal for the revision of MiFID which took the form of a revised Directive and a new Regulation.<sup>51</sup> After more than two years of debate, the Directive on Markets in Financial Instruments repealed Directive 2004/39/EC and the Regulation on Markets in Financial Instruments, commonly

referred to as MiFID II and MiFIR, were adopted by the European Parliament and the Council of the European Union.<sup>52</sup>

MiFID stands for the Markets in Financial Instruments Directive; It has been applicable across the European Union since November 2007.<sup>53</sup> It is a cornerstone of the EU's regulation of financial markets seeking to improve their competitiveness by creating a single market for investment services and activities and to ensure a high degree of harmonized protection for investors in financial instruments.<sup>54</sup> MiFID II/MiFIR entered into force on January 3, 2018.<sup>55</sup> ESMA created this new legislative framework will strengthen investor protection and improve the functioning of financial markets making them more efficient, resilient and transparent.

Within it, MiFID outlines the: (1) conduct of business and organizational requirements for investment firms; (2) authorization requirements for regulated markets; (4) regulatory reporting to avoid market abuse; (5) trade transparency obligation for shares; and (6) rules on the admission of financial instruments to trading.<sup>56</sup>

#### **b. ESMA Regulation of Cryptocurrency & Crypto-derivatives**

ESMA first stepped into the world of cryptocurrency when it expressed its view on token sales, also known as, ICOs, in November 2017.<sup>57</sup> Although ESMA's proclamation was vague and did little more than acknowledge the existence of cryptocurrencies and ICO's, later on, in the Call for Evidence Report issued in January 2018, the ESMA announced that crypto-derivatives, in the form of CFDs and BOs, should be subject to strict legal scrutiny. ESMA defines CFDs or "Contracts for Difference" as:<sup>58</sup>

*"a derivative other than an option, future, swap, or forward rate agreement, the purpose of which is to give the holder a long or short exposure to fluctuations in the price, level or value of an underlying, irrespective of whether it is traded on a trading venue, and that must be settled in cash at the option of one of the parties other than by reason of default or other terminational event."*

BO's, or Binary options, are defined as:<sup>59</sup>

*"a derivative that meets the following conditions: (a) it must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other terminational event; (b) it only provides for payment at its close-out or expiry; (c) its payment is limited to: (i) a predetermined fixed amount if the underlying of the derivative meets one or more predetermined conditions; and (ii) zero or another*



*predetermined fixed amount if the underlying of the derivative does not meet one of more predetermined conditions.”*

ESMA suggested that these derivatives products are speculative and volatile, exposing investors to potentially significant monetary loss.<sup>60</sup> As a result of its findings, ESMA called for responses from market participants regarding crypto-derivatives and adopted several restrictive product invention measures, stemming from its power under Art. 40 of MiFIR.<sup>61</sup>

The intervention measures included (1) a prohibition on the marketing, distribution, or sale of BOs and (2) a restriction on the marketing, distribution, or sale of CFDs to retail investors.<sup>62</sup> In adopting these restrictive measures, the ESMA is quoted as saying:<sup>63</sup>

*“CFDs are complex products. The pricing, trading terms, and settlement of such products is not standardized, impairing retail investors’ ability to understand the terms of product...Retail investors find it difficult to understand and assess the expected performance of a CFD... Furthermore, the offer of CFDs to retail investors has increasingly featured aggressive marketing practices as well as misleading communications...”*

Separately, it also noted that the cryptocurrency is an immature asset class that poses “separate and significant concerns.”<sup>64</sup>

## **Crypto-derivative Regulatory Status in EU Member Countries**

### **A. Banned**

In the following EU member countries, the trading of crypto-derivatives by retail investors are either completely banned or effectively banned.

### **Germany**

The German ‘Act Implementing the Amending Directive on the Fourth EU Anti-Money Laundering Directive’ made Germany one of the first countries in the world to enable financial institutions to custody crypto assets as a new type of ‘financial service’ by incorporating it into the German Banking Act (Kreditwesengesetz – KWG).<sup>65</sup>

As of January 1, 2020, entities wishing to offer this service need to apply for authorization from BaFin (the Federal Financial Supervisory Authority). This also applies to cross-border operators. German cryptocurrency regulations stipulate that German native citizens and legal entities can buy/sell/hold ‘cryptoassets’, as so long as they are held or acquired through a BaFin licensed exchange, custodian or Bitcoin ATM.<sup>66</sup>

However, in December of 2020, the German legislature approved a new bill called the "Law on the Introduction of an Obligation to Notify Cross-Border Tax Arrangements." The new law contains a provision that will have a significant impact on trading in derivatives in Germany for private investors after December 31, 2020. From 2021 and onwards, losses from forward transactions can only be offset against profits from forward transactions up to an amount of EUR 20,000 with profits from forward and silent partnership transactions according to the wording of the law. Investors may therefore not offset the losses with other investment income or with other income. Uncalculated losses may be carried over to subsequent years, whereby the limit in the amount and the limitation in the calculation continue to apply. This new regulation also applies to the loss offsetting of losses for the year.<sup>67</sup> This law has been described as effectively banning **all** derivatives trading by retail investors in Germany, beginning on January 1, 2021. However, this would not apply to German investors who qualify as professional traders.<sup>68</sup>

## Italy

The Italian legal system does not include a generalized definition of cryptocurrencies or virtual currencies; however, a statutory definition of virtual currencies was included in Legislative Decree no. 90 in 2017, which directly borrows from the European Union's AML 4 Directive. Under this definition, virtual currencies are:

*“Digital representation[s] of value, which [have] not been issued or backed by a central or public authority and which is not necessarily pegged to a legal tender, but which is used as a means of exchange for the purchase of goods or services or for investment purposes, and may be transferred, sorted or negotiated electronically.”*

Legislative Decree No. 90 of 2017 further subjected virtual currency providers (prestatori di servizi relativi all'utilizzo di valuta virtuale) to the regulations established for traditional money exchange operators. To that effect, Legislative Decree No. 90 also charged the Ministry of the Economy and Finance with issuing a ministerial decree setting forth the requirements and timelines for the legal performance of such activities throughout the country.

Accordingly, in early 2018, the Treasury Department, which is part of the Ministry of Economy and Finance, commenced a public consultation process on the proposed text of a ministerial decree. The decree will be focused on the methods and timing according to which providers of virtual currency services will be required to submit information concerning their Italian operations.

Nevertheless, in February of 2019, Italian financial markets regulator CONSOB gave a warning that put on notice a list of firms that were illegally engaging in crypto-related market

activity without regulation.<sup>69</sup> The blacklisted activities and services included the trading of crypto binary options, futures as well as CFD's by retail investors.<sup>70</sup> Italy has yet to give guidance on how to obtain proper regulatory approval for these activities, effectively halting crypto-derivative trading in the country.<sup>71</sup>

## Spain

There is no specific regulation for cryptocurrencies in Spain; however, they are not legal tender. However, similarly to ESMA, in February 2018 the Bank of Spain and the Spanish Securities and Exchange Commission (CNMV) published a joint communication on the dangers of investing and trading in cryptocurrencies, emphasizing that retail investors should avoid these investments.<sup>72</sup> The communique does not contain a normative definition of cryptocurrencies, although it describes concepts such as Initial Coin Offerings.

Furthermore, cryptocurrencies and virtual currency cannot be considered either as financial instruments (promissory note, derivative, etc).<sup>73</sup> Thus, the trading of crypto-derivatives is not allowed. In some cases, they can be treated as securities in the case of a public offer, or as goods or commodities if the coins themselves traded individually.<sup>74</sup>

But, as of April 7, 2021 the National Securities Market Commission (CNMV) has initiated the first steps of nationwide crypto regulations.<sup>75</sup> The coverage outlined that the potential regulations could affect almost all areas of the cryptocurrency industry.<sup>76</sup> However, the legislation could exempt some professional activities, assets that are exclusively used as means of payment, and non-fungible tokens

### **B. Legal**

In the following EU member countries, it is legal for retail investors to trade crypto-derivatives on OTC exchanges.

## France

Cryptocurrencies remain largely unregulated in France. However, the French Financial Market Authority (Autorité des marchés financiers, AMF) and Prudential Supervisory Authority (Autorité de contrôle prudentiel et de résolution, ACPR) issued a joint notice to retail investors in 2018, warning about the current unregulated nature of cryptocurrencies, in general.<sup>77</sup> Bitcoin and other cryptocurrencies are not considered financial instruments under French law, and therefore do not fall under the regulatory framework of actual currencies or under the AMF's supervision.<sup>78</sup>

However, the AMF has issued guidance on the status of cryptocurrency derivatives. The AMF has stated that “cash-settled cryptocurrency contracts may qualify as a derivative” ; as a result, any online platforms that offer crypto-derivatives fall within the scope of MiFID II and must comply with the statute’s requirements.<sup>79</sup> Furthermore, French law itself bans the advertisement of derivative financial contracts as a whole- this includes crypto-derivatives.<sup>80</sup> Thus, while it is legal for French retail investors to trade crypto-derivatives on OTC exchanges, it is neither encouraged nor advertised.

## Switzerland

Swiss law does not define the term “cryptocurrency” or “virtual currency”, and cryptocurrencies are not considered legal tender or “money.”<sup>81</sup> However, the Financial Market Supervisory Authority (FINMA) has indicated it has observed the sharp increase in the number of initial coin offerings planned or executed in Switzerland as well as an increase in the number of enquiries about the applicability of regulation to crypto activities.<sup>82</sup> As a result, FINMA has been forced to create a regulatory process to deal with these enquiries.

FINMA has indicated it will focus on the economic function and purpose of tokens being issued.<sup>83</sup> The key factors are the underlying purpose of the tokens and whether they are already tradeable or transferable. FINMA categorizes tokens into three types, but hybrid forms are possible:<sup>84</sup>

(1) Payment tokens are synonymous with cryptocurrencies and have no further functions or links to other development projects. Tokens may in some cases only develop the necessary functionality and become accepted as a means of payment over a period of time.<sup>85</sup>

(2) Utility tokens are tokens which are intended to provide digital access to an application or service.<sup>86</sup>

(3) Asset tokens represent assets such as participations in real physical underlings, companies, or earnings streams, or an entitlement to dividends or interest payments. These tokens are analogous to equities, bonds or derivatives.<sup>87</sup>

Trading in tokens that constitute derivatives may be subject to multiple derivatives trading obligations under the Financial Market Infrastructure Act. These obligations may include reporting, trade confirmation, portfolio reconciliation, portfolio compression, dispute resolution, and posting of initial and variation margins.

# APAC

## Hong Kong

### Overview

To date, Hong Kong's regulators have not promulgated direct restrictions on crypto derivatives. Rather, the current regulatory regime has developed from the public statements the Commission has issued since 2017 interpreting Hong Kong's pre-existing laws and regulations to cover new products and services.

### Regulation of Products, Secondary Markets, and Services

- Since 2017, the Securities & Futures Commission of Hong Kong (**SFC**) has stated that Bitcoin futures contracts, and other cryptocurrency-related investment products, may share the conventional features of a "futures contract" as defined in the Securities and Futures Ordinance (SFO).<sup>88</sup> Under the SFO, "futures contract" includes "a contract or an option on a contract made under the rules or conventions of a futures market."<sup>89</sup> Accordingly, while the SFC concedes that the underlying digital asset may be not expressly regulated under the SFO, they have concluded that digital asset futures traded on and subject to the rules of exchange are regarded as "futures contracts" for the purposes of the SFO. At the time this statement was issued, Bitcoin was the principal crypto-asset in existence and the Ethereum network was nascent. However, the SFC is likely to treat futures and options contracts with Ethereum and other crypto-assets as the underlying in a similar manner as Bitcoin-linked derivatives.

### Licensing Regime

- Under the SFO, Hong Kong imposes a comprehensive regulatory regime on intermediaries of crypto-derivatives. In 2019, the SFC issued a statement clarifying the legality of transacting virtual asset futures contracts.<sup>90</sup> The Commission noted that any trading platform or persons that offers and/or provides trading services in virtual asset futures contracts without a proper license or authorization may violate the SFO or the Gambling Ordinance (Cap. 148). The SFO is triggered depending on whether a virtual asset futures contract is structured such that it may be considered a "futures contract," as defined in the SFO (see note [90], above).<sup>91</sup> If a crypto-derivative product meets the definition of a "futures contract," then the SFO requires a person who operates a platform that offers or trades "futures contracts" to receive a

license or authorization to conduct such business, regardless of whether the business is located in Hong Kong.

- Specifically, the SFC has stated the following business activities expressly require licensing under the SFO, with respect to Bitcoin (and other?) Futures:<sup>92</sup>
  - Parties carrying on a business in dealing in virtual asset futures contracts, including intermediaries (i.e., those who relay or route orders for them), must receive a license for **Type 2 regulated activity** (“dealing in futures contracts”). Further, an intermediary for Type 2 regulated activity cannot not directly relay bitcoin futures orders for a non-SFC authorized exchange platform under Part III of the SFO. The list of exchanges authorised to provide automated trading services in Hong Kong can be found on the SFC website. As of the time of writing, it does not appear that Hong Kong has licensed or authorized any entity to offer or trade virtual asset futures contracts. Indeed, the SFC noted in 2019 that, given the risks of such contracts, “the SFC would be unlikely” to grant a license.
  - Marketing an investment fund in virtual asset futures may constitute **Type 1 regulated activity** (“dealing in securities”)
  - Managing such a fund may constitute **Type 9 regulated activity** (“asset management”).
  - The provision of advisory services in relation to Bitcoin Futures may also constitute **Type 5 regulated activity** (advising on futures contracts).
- Further, the SFC has stated that it expects that intermediaries to “strictly observe” the suitability requirement, under paragraph 5.2 (“Know your client: reasonable advice”) of the *Code of Conduct for Persons Licensed by or Registered with the SFC*, in addition to the conduct requirements concerning client services in derivative products, under paragraphs 5.1A (“Know your client: investor characterization”) and 5.3 (“Know your client: derivative products”).<sup>93</sup> These restrictions would apply if intermediaries make recommendations and solicitations to clients when providing services in relation to crypto-derivatives.<sup>94</sup>
- Beyond the activities described above, the SFC has also stated that additional licenses and regulations may apply to any other business services relating to crypto “futures contracts” which constitute a “**regulated activity**,” as defined by the SFO.<sup>95</sup>

- In addition, in 2019 the SFC issued a statement warning the public about the risks associated with the purchase of virtual asset futures contracts.<sup>96</sup> The Commission characterized such instruments as contracts that “allow investors to speculate on the prices of the underlying virtual assets at a future date,” and noted that they are “extremely risky” because they are typically highly leveraged and largely unregulated. Notably, however, the SFC excluded from this warning Bitcoin futures contracts that are traded CFTC-licensed US exchanges and approved by the SFC as providing an ATS in Hong Kong.
- **Unlicensed virtual asset futures contracts platforms may also be illegal under the Gambling Ordinance.** In 2019, the SFC issued a statement acknowledging that virtual asset futures contracts may be construed as contracts for differences under the Gambling Ordinance. The Ordinance defines “contract for differences” as “an agreement the purpose or effect of which is to obtain a profit or avoid a loss by reference to fluctuations in the value of price of property of any description or in an index or other factor designated for that purpose in the agreement.” Only gambling activities expressly authorized in the Ordinance are lawful, which crypto-asset futures are not.

### **Hong Kong’s 2019 Virtual Asset Services Providers Framework**

- In May 2021, Hong Kong’s Financial Services and Treasury Bureau (FSTB) issued a consultation conclusion introducing a new regulatory framework to license and regulate virtual asset (“VA Exchange”) operators.<sup>97</sup> Under this framework, the operation of a “**VA Exchange**” will be deemed a “regulated **virtual asset** activity” under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (“AMLO”). Thus, entities operating a VA Exchange must receive a virtual asset service provider (“VASP”) license from the Securities and Futures Commission (“SFC”) and are subject to the AML/CTF requirements provided under the AMLO.<sup>98</sup>
- Among other significant restrictions imposed by the new regime, VA Exchange operators are prohibited from offering their services to ‘non-professional,’ retail investors.<sup>99</sup> At present, only “professional investors,” i.e., high net-worth individuals, corporations, or institutional investors, may access licensed VA Exchanges.<sup>100</sup> The prohibition on retail may be temporary; indeed, the FSTB has indicated its commitment to continually evaluate the evolving maturity of the virtual asset market and its suitability for broader access. But without a set timeline, retail access remains out of the picture.<sup>101</sup> Last, the regime prohibits unlicensed VA Exchanges from

actively marketing--in Hong Kong or elsewhere--to the Hong Kong public a regulated virtual asset activity, or similar activity elsewhere.<sup>102</sup>

- For existing VA Exchange customers, the new regime generates substantial uncertainty. Beyond a commitment to ban retail access to VA Exchange services, the FSTB's public statement does not provide guidance as to how retail customers should trade or exit their current positions in virtual assets under the new regime. On the one hand, the new regime may allow for retail participation on decentralized, peer-to-peer platforms (explained below) which appear to be excluded from the definition of VA Exchange. Moreover, the regime appears to allow trading by retail investors through offshore VA Exchanges, so long as the exchanges have not actively marketed and solicited such customers. Lastly, the new regime appears to tolerate trading that occurs via over-the-counter virtual asset brokerage firms, so long as they do not meet the definition of a VA Exchange (below).<sup>103</sup>
- The FSTB broadly defines a VA Exchange as *any* trading platform that is operated for the purpose of allowing an offer or invitation to be made to buy or sell any virtual asset in exchange for any money or any virtual asset, and which comes into custody, control, power, or possession of, or over, any money or any virtual asset at any point in time during its course of business. While all-encompassing, this definition would appear to exclude decentralized virtual asset exchanges where trading occurs peer-to-peer or through an automated market maker. So long as a transaction occurs outside the platform and the platform does not come into possession of any money or virtual asset, then the platform would not be covered by the definition of a VA Exchange. However, any platform that takes margin deposits would appear to “come into custody, control, power, or possession of” money or virtual assets.
- The new regulation exempts VA Exchanges that have already received licenses under the prior opt-in regime, established by the Securities and Futures Ordinance (“SFO”).<sup>104</sup> These exchanges facilitate trading in at least one “security” virtual asset (as defined in the Securities and Futures Ordinance) and are licensed and supervised by the SFC.
- The new regime also provides clarity on the eligibility criteria of VA Exchanges who can apply for a license. Companies that are incorporated outside Hong Kong but are registered in Hong Kong under the Companies Ordinance may apply for a VASP license (in addition to Hong Kong incorporated companies). As a practical matter, this means that offshore VA Exchanges can apply for a VASP license by first establishing



a place of business in Hong Kong via a branch entity, register the branch with the Hong Kong Companies Registry, and then apply for a VASP license as a branch of the offshore company.<sup>105</sup>

- “Virtual assets” is defined to cover a digital representation of value that:
  - (i) is expressed as a unit of account or a store of economic value;
  - (ii) functions (or is intended to function) as a medium of exchange accepted by the public as payment for goods or services, or for the discharge of a debt, or for investment purposes; and
  - (iii) can be transferred, stored, or traded electronically.
- This definition appears to cover most cryptocurrencies, such as Bitcoin, Ether; however, its coverage of stablecoins, equity-linked tokens, among other new forms of crypto assets, remains open to interpretation. In favor of coverage, the FSTB notes that the definition of virtual assets applies equally to virtual coins that are stable or not, irrespective of the purported form of underlying assets (e.g., Tether).<sup>106</sup> Notably excluded from this definition are financial assets regulated under the SFO, namely, security tokens, in addition to digital representations of fiat currencies (thus, perhaps implicitly covering fiat-linked stablecoins).<sup>107</sup> More broadly, the FSTB noted that, given the evolving nature of the crypto world, it will provide flexibility for the SFC to prescribe characteristics that constitute a virtual asset.<sup>108</sup>

## Japan

In Japan, crypto derivatives are considered “financial instruments” under existing regulations. Thus, crypto<sup>109</sup> derivatives transactions and crypto asset margin trading are generally regulated as Type I Financial Instrument Business Operators (“FIBOs”) by the Japanese Financial Services Authority (JFSA), under the country’s national regulations on derivative transactions. Three notable exceptions to this licensing regime are as follows:

- (i) derivatives transactions occurring on completely decentralized platforms, without an operator; and
- (ii) users who engage in derivatives transactions and thus while providing liquidity, are generally classified as unregulated, proprietary traders; and
- (iii) platforms that do not directly engage in derivatives transactions

Each area is explored in greater detail below, as follows: first, the regulations governing specific products; second, the laws governing secondary trading; and third, the laws governing custody services. In Japan, because regulations are so comprehensive, an entity conducting business activity concerning crypto derivatives is likely to confront all three areas of the law.

### **Derivatives and Digital Assets Under the FIEA and the PSA**

Currently, crypto asset-related derivatives are covered by the Japanese Financial Instruments and Exchange Act's (FIEA's) definition of "derivatives" and are regulated thereunder. In 2019 amendments to FIEA, Crypto Assets, defined in Article 2, paragraph 5 of the amended PSA, were included in the term "Financial Instruments," which defines the underlying assets of derivatives transactions.<sup>110</sup> As a result, engaging in business to provide or intermediate crypto asset-related derivatives products and/or transactions constitutes either a Type I or Type II Financial Instrument Business.<sup>111</sup> The particular regulations flow from how the transaction is structured, such as the particular underlying (or reference) and where it is conducted (i.e., market or OTC).

### ***Digital Assets as "Financial Instruments"***

Crypto assets, defined below, are "Financial Instruments" within the meaning of FIEA.<sup>112</sup> Therefore, the FIEA covers derivatives using a digital asset as underlying or crypto asset indices as reference individuals.<sup>113</sup> In Japan, two acts - the Payment Services Act (PSA) and the FIEA - define certain types of digital assets. These definitions are essential to understand the category or derivative product may classify under (and the regulatory regime thereby triggered).

- **Cryptocurrencies:** Type I Crypto Asset under the PSA.<sup>114</sup>
- **Utility Tokens:** Type II Crypto Asset under the PSA.<sup>115</sup>
- **Investment Tokens:** Tokenized Securities ("Paragraph I Security") and Electronically Recorded Transfer Rights ("Paragraph II Security") under the FIEA.<sup>116</sup>

### ***"Derivative Transactions" Under FIEA***

Under the FIEA, "Derivative Transactions" is a defined term, referring to three categories of transactions:

- Type (1)—transactions where assets subject to spot transactions are used as "underlying assets," i.e., "Financial Instruments." As noted above, "Financial Instruments" include Crypto Assets, Securities, deposit claims, currencies, and commodities, and "assets for which there are many of the same kind, [and] which

have substantial price volatility” may be designated by Cabinet Order.<sup>117</sup> Type (1) transactions also include futures and forward transactions<sup>118</sup> and Option transactions.<sup>119</sup>

- Type (2)—transactions where numerical values, which are not subject to spot transactions themselves, are used as “reference indicators.” Type (2) transactions include:
  - index futures transactions / index forward transactions,<sup>120</sup>
  - Option transactions,<sup>121</sup> index Option transactions,<sup>122</sup>
  - swap transactions,<sup>123</sup>
  - commodity swap transactions<sup>124</sup>
- Type (3)—any other type of transactions, which covers credit derivative transactions.<sup>125</sup>

In addition:

- “Market Transactions of Derivatives” are defined as Derivative Transactions conducted in a Financial Instruments Market, in accordance with requirements and by using methods prescribed by the operator of the Financial Instruments Market. See Article 2(21) of the FIEA.
- “Over-the-Counter Transactions of Derivatives” are defined as a type of Derivative Transactions that are conducted in neither a Financial Instruments Market nor a foreign Financial Instruments Market. See Article 2(22) of the FIEA.
- “Foreign Market Derivatives Transactions” are defined as transactions which are conducted in a Foreign Financial Instruments Market and are otherwise similar to Market Transactions of Derivatives. See Article 2(23) of the FIEA.

### ***Relationship Between “Derivatives” and “Securities”***

Under the FIEA, both “Derivative Transactions” and “Securities” are regulated as Financial Instruments/transactions with an investment character. The difference, however, between the two is that “Securities,” under FIEA, are instruments that indicate *rights*; whereas, “Derivative Transactions” are *acts*. These differences, as a practical matter, mean that certain acts concerning “Securities” (e.g., sales and purchases of them) are subject to the regulations on conducting business or the regulation on activities under the FIEA. For “Derivatives Transactions,” the act of such a transaction itself is subject to the regulations on conducting business or the regulations on activities. Further, unlike “Securities,” which are subject to the disclosure regulation under the FIEA (because they contribute to the Investment Decisions of investors), “Derivative Transactions” are not subject to disclosure

regulation.<sup>126</sup> By contrast, the regulations on activities relating to sales and solicitation separately create the obligation to provide investors information on “Derivatives Transactions.”

### ***‘Financial Instruments Business’ Registration***

A person registered for Financial Instruments Business (a “Financial Instruments Business Operator,” “FIBO”) may be eligible to conduct both securities derivative transactions and financial futures transactions. In an effort to streamline and simplify the registration procedure, FIEA consolidates various business operations that were conventionally regulated by individual laws governing discrete business transactions into “Financial Instrument Business.”<sup>127</sup> Accordingly, securities derivative transactions and financial futures transactions (which were regulated separately) are categorized as “Derivative Transactions”<sup>128</sup> under FIEA and are included within the scope of Financial Instrument Business.<sup>129</sup> However, FIEA requires different licenses for specific types of Derivatives Transactions, as described below:

- **“Type 1 Financial Instrument Business”**: This category includes (i) Market Transactions of Derivatives and (ii) Foreign Market Derivatives Transactions concerning highly liquid “Securities” (i.e., “Paragraph (1) Securities”); and (iii) OTC Transaction of Derivatives. Registration for Type I license carries strict market entry requirements, discussed below.<sup>130</sup> **Paragraph I Securities** are publicly available and broadly distributed (i.e., highly liquid); under the FIEA, tokens concerning STOs generally fall under the Paragraph I classification, to the extent that they represent traditional securities by giving ownership in the issuer.
- **“Type 2 Financial Instrument Business”**: This category includes (i) Market Transactions of Derivatives and (ii) Foreign Market Derivatives Transactions concerning less liquid Securities (“Paragraph (2) Securities”) and (iii) Financial Instruments other than Securities—notably Crypto Assets. Registration for Type II licenses carry relatively simplified market entry requirements.<sup>131</sup> Paragraph II Securities are narrowly distributed and typically represent interests in collective investment schemes; under the FIEA, ICO tokens are classified as a Paragraph 2 security.

### ***Type 1 Financial Instrument Business***

Engaging in business activities to offer investment advice or management for Crypto Asset-related derivatives qualifies as an Investment Advisory Business or Investment Management Business, requiring registration under the FIEA and be subject to stringent rules, such as the

capital adequacy test.<sup>132</sup> An existing registered financial instrument business operator that is engaged in a derivatives business must file an amendment to existing documents to engage in Crypto Asset-related derivatives business. Moreover, if a Type 1 Financial Instrument Business Operators and registered investment advisors/managers engage in Crypto Asset-related derivatives businesses, they are required to notify the FSA and provide specific disclosure.<sup>133</sup>

- **Conduct Rules:** Under the amended FIEA, certain conduct rules govern operators of Type 1 Financial Instrument Businesses related to crypto derivatives. Some of these restrictions are similar to those governing operators of currency derivatives businesses. For crypto-related businesses, the FIEA requires, inter alia:
  - Certain information disclosed on Crypto Assets and accompanying risks,
  - Implementation of rules and procedures for detecting and preventing transactions in violation of deceptive and fraudulent trade prohibitions, market manipulation, and other inappropriate conduct.
  - Further, uninvited solicitations to transact are restricted. And any Financial Instrument Business Operator entering into a renewable Crypto Asset-related derivatives transaction must receive security deposits similar to margin transaction requirements imposed on Crypto Asset Exchange Service Providers.<sup>134</sup>

### ***Cash/Crypto-Settlement***

The FIEA requires that “on-market derivative transactions” and “OTC derivative transactions” be cash settled. However, the 2019 Amendments established that Crypto Assets are deemed as “cash” for such purposes, and satisfy the FIEA’s cash-settlement regulation. Note, however, that providers of Crypto Asset-related derivatives services who also hold customer Crypto Assets in custody may also be deemed a Crypto Asset custodian, which designation would require registration as a custodian *and* a Crypto Asset exchange.<sup>135</sup> These regulations are discussed in greater detail below (“Custody”).

### ***Broker/Dealer Regulation***

The amended FIEA treats investment interests in partnerships, transferable through a blockchain, as “securities.” As a result, broker/dealer business activities regarding security tokens<sup>136</sup>—Crypto Assets where holders will participate in profits/losses of the issuer—constitute a Type 1 Financial Instrument Business, unless exempted.<sup>137</sup> A business that operates an exchange market for security tokens is deemed an operator of a securities exchange market (and requires further licensing and operational requirements). Further, the

FIEA obligates Broker/dealers to disclose to customers the nature of Crypto Assets in accordance with JFSA rulemaking. The Act also prohibits broker-dealers from making misleading representations when soliciting Crypto Asset derivative transactions. (See also Margin Requirements, above.)

### ***Prohibitions on Unfair Trading***

A separate (and new) chapter of the FIEA prohibits various unfair trading practices in Crypto Asset-related transactions and Crypto Asset derivative transactions.<sup>138</sup> This chapter largely prohibits trading practices in the context of conventional securities to Crypto Assets and derivatives, such as fraudulent or deceptive acts, and market manipulations—with an important exception. The 2019 Amendment to FIEA does not include a prohibition on insider trading, given what JFSA characterized as the complexity of identifying the issuer of a Crypto Asset and the causes of price fluctuations—in other words, as the JFSA notes, it is difficult to identify *material* information for investment decisions in the crypto space.

### **Regulation of Secondary Markets--Exchanges and Traders**

Since crypto derivatives are financial instruments, entities engaging in derivatives transactions in the course of their business must generally register as a Financial Instruments Business Operator. This is true regardless of whether the derivative is fiat- or crypto-settled. However, marketplaces for crypto derivatives--i.e., crypto derivatives platforms--do not have to register as FIBO, concerning entering into such transactions, if they do not engage in transactions with their users. However, a platform will likely still need to register with the FSA because deposit-taking services--i.e., platforms that require margin accounts--are generally considered a crypto asset exchange service. This restriction covers not only centralized platforms that take deposits, but decentralized (e.g., hybrids that use off-chain order book and order matching with on-chain settlement) ones as well. Finally, users--retail and institutional alike--entering into derivatives transactions generally fall into the “proprietary trading” category, and are therefore potentially exempt from registering with the FSA.

### ***Trading Derivatives***

As detailed above, the FIEA designates two main types of derivatives transactions—Market Derivative Transactions and OTC derivative transactions. Market derivatives transactions are conducted on a financial instruments market while OTC derivatives transactions are ones performed on a bilateral basis. Entities that engage in crypto derivatives transactions engage in the financial instruments business, per the FIEA.<sup>139</sup> As a result, they must register

as a Type I FIBO.<sup>140</sup> While a limited exception to the registration requirement exists, it is explicitly excluded from the exemption.<sup>141</sup> Even so, if a FIBO conducts an OTC crypto derivatives business in Japan but executes a covered transaction with a person engaging in the crypto derivatives business lawfully in another jurisdiction, then the foreign entity does not have to register as a Type I FIBO in Japan.<sup>142</sup>

Proprietary Trading Exemption: In general, under the FIEA, proprietary trading of securities does not qualify as financial instruments business to the extent that a trading entity deals only with a small number of people in discrete transactions.<sup>143</sup> Hence, most user-trading is unregulated, apart from leverage caps on retail investors.

Margin Trading: Retail traders cannot exceed 2x leverage for crypto derivatives transactions. For corporations, while there is no ceiling on leverage as a matter of law, leverage cannot exceed a ratio determined by the service provider on a case-by-case basis.<sup>144</sup>

### ***Crypto Asset Exchanges***

The PSA regulates crypto asset exchanges and other businesses providing crypto asset exchange services. Crypto asset exchange services are defined to cover not just crypto asset exchanges, but also other service providers. Businesses must register with the FSA if they carry out the following activities:

- **Purchase and sale** of crypto assets or exchange with other crypto assets.
- **Intermediary, brokerage, or agency services** for the purchase and sale of crypto assets, or exchange with other crypto assets.
- **Custody services** for crypto assets, such as deposit-taking for margin accounts.<sup>145</sup>

Further, businesses registered as crypto asset exchanges must comply with corporate governance and security protocols to ensure fair dealing and mitigate operational risk.<sup>146</sup> For instance, these duties include, among others, the following:

- Establish and maintain a business management system;
- Comply with AML/CFT regulations;
- Ensure the protection of customers' funds (via segregation of funds, storing funds in "cold wallets," and retaining capital equal to users' funds held in a hot wallet);
- Implement and maintain information security management systems;
- Prepare, submit, and maintain records concerning crypto asset exchange services;
- Prohibiting misleading advertisement and the advertisement of speculative trading;
- Prohibiting and reporting unfair trading practices;

- Make prior notification to JFSA before listing new tokens and changing the scope of crypto asset exchange services.

Human Resources: Notably, the FIEA requires Crypto Asset Exchange Service Providers<sup>147</sup> that provide derivative transactions to maintain adequate human resources and operational systems to provide appropriate derivative-related transactions. To operationalize this requirement, JFSA requires Crypto Asset exchanges that intend to enable customers to trade Crypto Asset derivatives to describe this intention in its application for registration. For broker-dealers in financial instruments, an identical rule applies to BD-registration applications if a BD intends to deal with Crypto Asset derivatives. If an exchange or BD is already registered, they are required to notify the JFSA of such intention

### ***Financial Instruments Exchanges***

Under the FIEA, only two types of entities may establish and operate a financial instruments exchange—a financial instruments membership corporation or a stock company.<sup>148</sup> A financial instruments member corporation is an entity established by a FIBO to operate a financial instruments exchange; but unlike exchanges established by stock corporations, they cannot be operated for profit.<sup>149</sup> Among other restrictions, stock companies must have a stated capital of at least JPY\$1 billion to establish a financial instruments exchange.<sup>150</sup> Presently, five stock exchanges operate in Japan; two are established as financial instruments member corporations, three as stock companies. As of the time of writing, none have expressed an intention to establish an exchange for security tokens or crypto derivatives.

### **Regulation of Custody Services**

In general, traders must deposit a margin to trade in crypto derivatives under the policies of crypto derivatives platforms. This is true whether the user trades on a centralized or decentralized platform, even if the mechanics of posting margin are different (i.e., in the decentralized context, margin is often automatically withdrawn via a smart contract used by the platform). The regulation of custody turns on what asset is deposited: a Crypto Asset (Ethereum, Bitcoin, &c), fiat, or, more commonly on crypto derivatives platforms, in stablecoin. The PSA would apply to Crypto Asset-denominated margin accounts. For stablecoins, the analysis turns on whether the particular coin is classified as a Crypto Asset (thus, triggering the PSA analysis) or a money order, whose custody services remain unregulated.

The amended PSA defines what it means to be engaged in the provision of Crypto Asset custody services.<sup>151</sup> Under the FIEA, services that do not sell, purchase, or exchange virtual



currencies (i.e., exchange services), but only manage virtual currencies and transfer virtual currencies to designated addresses based on users' instructions (i.e., "Custody Services" or wallet services), are regulated as crypto-asset exchange services.<sup>152</sup> Businesses that provide management services require a Type I financial instrument broker-dealer registration. Further, the 2019 Amendment expanded the scope of this rule by expanding the coverage of 'Crypto Asset exchange business' under the Payment Services Act to include the holding of Crypto Assets on behalf of clients. Thus, Crypto Asset custodians must register with the JFSA as a crypto currency exchange service provider.<sup>153</sup> The policy behind this regulation is to hold custodian service providers to the same degree of accountability as exchange services providers for risks such as loss of clients' Crypto Assets and compliance with AML/CFT laws. They must also develop internal control systems and implement segregated management of customer accounts.<sup>154</sup>

### ***Customer Assets***

Under the amended PSA, Crypto Asset Exchange Service Providers must, subject to limited exceptions, hold customer cash in a trust account and Crypto Assets in "cold wallets [or their] "equivalents."<sup>155</sup> And Crypto Asset Exchange Service Providers must hold its own Crypto Assets as security for potential customer claims in an amount equal to the customer assets held in hot wallets for exchange purposes. No more than 5% of the aggregate value of customer Crypto Assets held in custody can be held in a hot wallet.<sup>156</sup> Crypto asset exchange service providers must audit their crypto and cash assets by a CPA (or qualified accounting firm) annually.

## Singapore

### Introduction

In Singapore, the relevant regulator for crypto-derivatives is the Monetary Authority of Singapore (“**MAS**”), which is Singapore’s central bank and integrated financial regulator.

The MAS is responsible for administering and supervising the securities, financial advisory services, and payments regimes in Singapore, under the Securities and Futures Act (“**SFA**”), Financial Advisers Act (“**FAA**”) and Payment Services Act 2019 (“**PSA**”), respectively. Entities and individuals that intend to conduct activities relating to crypto-derivatives, are required to comply with the MAS’ rules under the aforementioned regimes.

Whilst crypto-derivatives are not prohibited in Singapore, the MAS has indicated that it does not consider crypto-derivative products to be suitable for most retail investors.<sup>157</sup>

### Assessing Whether a Crypto-derivative is Regulated

The primary factor determining the regulatory treatment of a crypto-derivative product is the nature of the token that the product references.

Depending on the nature of the token, the product will be regulated in Singapore if: (i) it falls within the definition of a “capital markets product” under the SFA; or (ii) references a payment token (a “**payment token derivative**”), and is offered or listed on an approved exchange.

#### 1. Capital Markets Products

Under the SFA, “capital markets products” include securities, units in a collective investment scheme (“**CIS**”), derivatives contracts, spot foreign exchange contracts for the purposes of leveraged foreign exchange trading, as well as any other products the MAS has prescribed as a capital markets product.

Of these categories, a crypto-derivative product is most likely to fall within the definition of a “derivatives contract”, since the SFA defines a “derivatives contract” as a contract or arrangement under which:

- (i) one of the parties is required to, discharge all or any of its obligations at some future time; and
- (ii) the value of the contract or arrangement is determined by reference to the value or amount of one or more “underlying things”.

According to the MAS' FAQs on product definitions, the following would be considered "derivatives contracts": (i) futures swaps (i.e. a swap on a futures contract), or any other swaps; and (ii) contracts for differences referencing an "underlying thing".<sup>158</sup>

An "underlying thing" includes: a security, a unit in a CIS, a currency or currency index, an interest rate, a commodity or the credit of any person. If the reference token of the product is within the definition of an "underlying thing", the product is likely to be a "derivatives contract" and thus regulated as a "capital markets product".

The next few sections summarise some of the relevant licensing requirements that could apply to a crypto-derivative product that is considered a "capital markets product" under the legislation administered by the MAS.

### ***CMS licence***

An entity that carries on a business in any regulated activity under the SFA, will be required to hold a capital markets services ("**CMS**") licence for such regulated activity.

Regulated activities under the SFA include: (a) dealing in capital markets products; (b) advising on corporate finance; (c) fund management; (d) real estate investment trust management; (e) product financing; (f) providing credit rating services; and (g) providing custodial services.

### ***Financial advisors licence***

Any person that acts as a financial adviser in Singapore in respect of any financial advisory services, is required under the FAA to either hold a financial adviser's licence or be an exempt financial advisor. A financial advisory service includes advising others in respect of any "investment products" (which includes capital markets products).

### ***Markets where derivatives contracts are listed***

Entities and exchanges that provide a place or facility (whether electronic or otherwise) where, offers or invitations to exchange, sell or purchase derivatives contracts are regularly made on a centralised basis, may require approval or recognition from the MAS as either (i) an approved exchange or (ii) a recognised market operator.

## **2. Payment Token Derivatives**

### ***Approved exchanges***

A crypto-derivative product will be regulated if it references a payment token and is listed on an approved exchange.

As of September 2021, there are only four approved exchanges in Singapore: Asia Pacific Exchange Pte. Ltd.; ICE Futures Singapore Pte. Ltd., Singapore Exchange Derivatives Trading Limited; and Singapore Exchange Securities Trading Limited.

Based on public media comments by the MAS, the MAS considers Bitcoin and Ether to be payment tokens. Derivatives that reference Bitcoin and Ether would therefore be payment token derivatives and are regulated if listed on these approved exchanges.

If payment token custody services are provided in relation to payment token derivatives offered on an approved exchange, the MAS will require the approved exchange to be responsible for the appointment of the custodian. The custodian will also be subject to similar regulation that a custodian of securities or other capital markets products is subject to.

### ***Additional Measures for Retail Investors***

The MAS has also introduced additional measures for retail investors who trade in payment token derivatives with financial institutions regulated by the MAS. Such financial institutions are required to collect from retail investors 1.5 times the standard amount of margin required by approved exchanges for a comparable contract. This is subject to a floor of 50% and a cap of 100% of the notional value of the payment token derivatives contract. These margin requirements must be supplemented with other measures such as tailored risk warnings and restrictions on advertising.

## **South Korea**

### **Overview**

At present, the Republic of Korea's laws and regulations do not expressly regulate crypto derivatives. However, the Financial Investment Services and Capital Markets Act (the "FSCMA") may apply to a crypto derivative product if it is deemed a "derivative" under the FSCMA.<sup>159</sup> From that threshold classification follows ancillary restrictions on intermediaries and traders engaged in related activity.

South Korea is likely to recalibrate its hands-off approach in the face of recent negative public opinion and criticism about the reluctance on behalf of the country's primary banking and securities regulator, the Financial Services Commission (FSC), to directly regulate crypto-asset products. Thus, the FSC has issued new regulations that aim to not only significantly restrict all operators of digital-asset-related business activity and trading; but

also, to legitimize and regulate expressly cryptocurrency exchanges. As a result, the current regulatory environment, while in flux, has led to a wave of exchanges exiting the South Korean marketplace.<sup>160</sup> The following section outlines the regulations likely governing crypto-derivatives products and their trading.

### **Are Crypto-Derivatives “Derivatives”?**

The threshold legal question is whether crypto-assets can be considered as an “underlying asset” for purposes of the definition of “derivative” under the FSCMA. Korean financial regulators have stated unofficially that bitcoin futures may not be considered a “derivative” under the FSCMA because bitcoin would not fall under any of the stated categories of “underlying assets” in the FSCMA.<sup>161</sup> However, this position was stated solely with respect to bitcoin futures and perhaps with the intent of cautioning local securities companies from engaging in such crypto-asset activity.

- Despite this position, the SFC’s decision-making in other contexts may provide more insight in their thinking moving forward. Indeed, Korea’s regulators have consistently interpreted the term “underlying assets” for the purpose of the FSCM to include a broad set of asset classes. They may similarly take an inclusive stance in the case of cryptocurrency derivatives and futures products, in light of the growing popularity of non-spot exchanges in the crypto marketplace. A broadening of the term “underlying assets” appears even more likely in light of the 2018 Supreme Court of Korea’s (albeit narrow) ruling that cryptocurrencies are property.

### **Regulation of Traders**

Since 2017, the FSC has prohibited individual investors from borrowing funds (or cryptocurrency) from cryptocurrency exchanges in order to trade. According to the FSC, such margin trading violated existing lending and credit laws. In turn, the FSC also instructed financial institutions to not process margin-trading-related transactions and end partnerships that facilitated margin trading on crypto-exchanges.

### **Regulation of Broker-Dealers**

A person engaging in the business of trading, dealing and or brokering “derivatives,” which is classified as “financial investment business,” is required to obtain a relevant license or register with the Financial Services Commission.

# Anti-Money Laundering & Crypto-Derivatives

## International AML Framework

Anti-money laundering (AML) laws vary across all countries but generally fit within a standard framework established through the Financial Action Task Force (FATF) and various regional bodies associated with FATF. FATF, an inter-governmental organization created in 1989, is the international standard-setting body for laws aimed at AML and counter-terrorist financing. While FATF promulgates standards as agreed to by its member states, it is left to member states to adopt laws based on those standards. As a result, FATF guidance on particular AML-related issues carries significant weight in how national AML laws are implemented.

Traditionally, civil and criminal AML laws apply to all natural and legal persons in a given jurisdiction to prohibit involvement in transactions that are intended to launder ill-gotten funds. Additionally, AML laws and regulations under the FATF framework require financial intermediaries to have risk-based AML policies that are prophylactic in nature to detect and prevent money laundering and terrorism financing. FATF's recommendations to national authorities required that a broad category of "financial institutions" must conduct customer due diligence (CDD) and retain records sufficient to reconstruct individual transactions.<sup>162</sup> "Financial institutions" under the Recommendations include various intermediaries in banking, lending, money transmittal, custody, fund management, and trading of financial instruments including derivatives.<sup>163</sup>

Prior to 2018, the FATF recommendations were silent as to digital assets. In October 2018 under the rotating presidency held by the US representative, FATF proposed recommendations to member states on the application of AML laws to "virtual assets" (VAs) and "virtual asset service providers" (VASPs). FATF refined these recommendations in a June 2019 Interpretive Notice, with annual reviews of guidance in June 2020 and June 2021.

FATF's recommendations define a VASP as:

"any natural or legal person who is not covered elsewhere under the Recommendations, and as a business conducts one or more of the following activities or operations for or on behalf of another natural or legal person:

- i) exchange between virtual assets and fiat currencies;
- ii) exchange between one or more forms of virtual assets;

- iii) transfer of virtual assets;
- iv) safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and
- v) participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.”<sup>164</sup>

The Recommendations provide that “[i]n this context of virtual assets, transfer means to conduct a transaction on behalf of another natural or legal person that moves a virtual asset from one virtual asset address or account to another.”

FATF's recommendations would require VASPs to be licensed or registered at the national level “at a minimum...in the jurisdiction(s) where they are created.” This license need not be a separate licensing or registration system if the existing “financial institutions” licenses already cover the relevant VASP activities.

Of note, the FATF Recommendations would require VASPs to “obtain and hold required and accurate originator information and required beneficiary information on virtual asset transfers, submit the above information to the beneficiary VASP or financial institution (if any) immediately and securely, and make it available on request to appropriate authorities.” This requirement, known colloquially as the “travel rule,” would apply to any transaction over EUR 1,000 or USD 1,000.

### **Implementation at the National Level**

FATF members are expected to implement the Recommendations as part of their national law. As of April 2021, 28 FATF members and 30 FATF-style regional bodies (FSFB) members of associated inter-governmental organizations have implemented or proposed laws or regulations to implement the recommendations relating to VASPs. As discussed below in a partial survey of countries, some jurisdictions have created new registration categories for VASPs while others, notably the US, have relied on applying existing registration frameworks to VASP activities.<sup>165</sup>

#### ***United States***

The United States has an existing regulatory framework governing traditional derivatives trading, including registration requirements for brokerage, exchange, and clearinghouse functions. Coupled with other regulatory regimes at the state and federal level covering other financial activities, the existing United States regulatory framework covers a broad

swath of activities captured in the FATF Recommendations on VASP activities. As a result, the United States has not proposed any VASP licensing or registration, although there have been proposals in Congress to regulate spot exchanges at the federal level in various capacities.

United States AML requirements are primarily found in the Bank Secrecy Act of 1970 (BSA) and related regulations, which attach requirements for various financial institutions to have risk-based AML policies. Intermediaries in the futures and swaps markets subject to AML obligations include futures commission merchants (FCMs) and introducing brokers (IBs).<sup>166</sup> Neither the BSA nor CFTC regulations explicitly place AML obligations on swap dealers (SDs), although SDs generally have AML obligations by virtue of their dual status as FCMs and/or SEC-registered broker-dealers, or through their affiliation with a bank. For futures markets that are not intermediated by FCMs, the CFTC has attached requirements to the clearinghouses of those products to perform AML obligations as if the clearinghouse were a “financial institution” under the BSA.<sup>167</sup> Additionally, an entity not registered with the CFTC or SEC may be required to register with the Financial Crimes Enforcement Network (FinCEN) as a money services business (MSB) if it performs various activities, including acting as a money transmitter or provider of stored value accounts.<sup>168</sup> This may capture various customer-related activities in digital asset derivatives markets even if the entity involved is not required to register as an intermediary with the CFTC.

While the United States has not proposed any VASP-specific registration regimes, it has proposed amendments to its AML regulations that are specific to virtual currency transactions. In December 2020, the Department of the Treasury issued a notice of proposed rulemaking that would have required banks and MSBs to verify customer identities and report transactions over US\$3,000 for transactions involving “convertible virtual currencies” held in unhosted wallets. Following significant negative reactions to the timelines for comment, and the difficulties in implementing the proposed requirements, the incoming Biden Administration Treasury Department reopened the comment period on the rule. Since January 2021 and as of writing, the administration has not made any indications of an intent to proceed to final adoption.

### **Application of AML laws to non-traditional derivatives markets**

While the existing AML framework is designed to address risks within traditional derivatives markets, the rise of crypto-only derivatives platforms raises novel issues. Reduced dependence on the banking system, a limited or even non-existent physical presence, and trade execution and settlement through smart contracts rather than traditional intermediaries



can each impact the application of existing AML regulations to these new derivatives markets.

The growth of digital assets as an asset class has spawned a new type of marketplace, beyond derivatives offered on traditional venues fully licensed by local regulatory authorities. Many new platforms are still centralized in terms of operating a single central limit order book, holding collateral, and settling trades when positions are closed. However, these new centralized finance platforms are less reliant on banking rails and can service a worldwide set of participants without being tied to a physical location.

Jurisdictions may face difficulty applying AML regulations based on the country of incorporation or physical presence to these non-traditional platforms. However, the United States has used its existing AML regulations against one such platform, using as a jurisdictional hook that the entity acted as a futures broker with respect to US-based customers and was therefore subject to US AML criminal laws and civil derivatives regulations.<sup>169</sup>

While some centralized platforms have operated without significant geographic or banking ties, other platforms have developed with limited oversight by a centralized operator. Decentralized finance or “DeFi” platforms use smart contracts to lock up collateral and settle trades without assets being held by any centralized market operator or clearinghouse. This novel arrangement raises questions about what entities in this structure function as “financial entities” and would therefore be required to have prophylactic AML policies in place.

## Next Steps

This global crypto-derivatives regulatory report maps an initial set of twelve key jurisdictions to demonstrate the nascent but burgeoning regulatory and legal considerations. We hope this initial report provides the foundations for further work and analysis of the crypto-derivatives markets and the opportunities and challenges as this vertical evolves. We expect to expand our jurisdictional reach in GSMI 3.0 (in 2022) as well as deepen our analysis of evolving standards and / or frameworks. Crypto-derivatives professionals are welcome to join GSMI 3.0 as we continue to research, document, and map this segment of crypto-product development and growth.

## Endnotes

- 1 Namely, onions and box office receipts.
- 2 7 U.S.C. § 1a(9).
- 3 Testimony of Chairman Timothy Massad before the U.S. Senate Committee on Agriculture, Nutrition & Forestry (Dec. 10, 2014), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-6>.
- 4 *In re Coinflip, Inc.*, CFTC No. 15-29, at 3, 2015 WL 5535736 (Sept. 17, 2015).
- 5 See, for example, *In re BFXNA Inc.*, CFTC No. 16-19, at 5-6, 2016 WL 3137612, at \*5 (June 2, 2016) (“[V]irtual currencies are encompassed in the definition [of the CEA] and properly defined as commodities.”)
- 6 See, for example, *Commodity Futures Trading Comm’n v. McDonnell*, 287 F.Supp.3d 213, 228 (E.D.N.Y. 2018) (“Virtual currencies can be regulated by CFTC as a commodity.”); *Commodity Futures Trading Comm’n v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492, 495 (D. Mass. 2018).
- 7 7 U.S.C. § 2(a)(1).
- 8 See, e.g., *CFTC v. Hanover Trading Corp.*, 34 F.Supp.2d 203, 205 (S.D.N.Y. 1999); *Salomon Forex, Inc. v. Tauber*, 8 F.3d 966, 971 (4th Cir. 1993).
- 9 See, e.g., *CFTC v. International Financial Services (New York), Inc.*, 323 F.Supp.2d 482, 494 (S.D.N.Y. 2004).
- 10 17 C.F.R. § 38.601.
- 11 7 U.S.C. § 1a(47).
- 12 7 U.S.C. § 2(e).
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- 14 7 U.S.C. § 6c(b).
- 15 17 C.F.R. § 32.2.
- 16 *In re Coinflip, Inc.*, CFTC No. 15-29, at 3, 2015 WL 5535736 (Sept. 17, 2015).
- 17 Retail Commodity Transactions Involving Certain Digital Assets, 85 Fed. Reg. 37,734 (June 24, 2020), available at <https://www.govinfo.gov/content/pkg/FR-2020-06-24/pdf/2020-11827.pdf>.
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- 19 Chairman Tarbert Discusses U.S. Leadership in Digital Assets on CNBC (Nov. 20, 2019), available at <https://www.cftc.gov/PressRoom/PressReleases/8082-19>.
- 20 Remarks of Gary Gensler, Chair of the Securities and Exchange Commission, Before the American Bar Association Derivatives and Futures Law Committee Virtual Mid-Year Program (Jul. 21, 2021), available at <https://www.sec.gov/news/speech/gensler-remarks-aba-derivatives-futures-law-committee-virtual-mid-year-program-072121>.
- 21 15 U.S.C. § 77e(e).
- 22 *In re Plutus Financial Inc. d/b/a Abra*, Adm. Proc. File No. 3-19873 (SEC) (July 13, 2020); *In the Matter of Plutus Financial, Inc. d/b/a/ Abra*, CFTC Docket No. 20-23 (July 13, 2020).
- 23 7 U.S.C. § 2(a)(1)(D).
- 24 15 U.S.C. § 78f(g)(2).
- 25 See, for example, Order Setting Aside Action by Delegated Authority and Disapproving a Proposed Rule Change, as Modified by Amendments No. 1 and 2, to List and Trade Shares of the Winklevoss Bitcoin Trust (Jul. 28, 2018), available at <https://www.sec.gov/rules/other/2018/34-83723.pdf>.
- 26 Remarks of Gary Gensler, Chair of the Securities and Exchange Commission, Before the Aspen Security Forum (Aug. 3, 2021), available at <https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03>.
- 27 CSA Staff Notice 21-329, *Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements* (Mar. 29, 2021), [https://www.securities-administrators.ca/uploadedFiles/Industry\\_Resources/JointCSAIIROCNotice21-329\(March29\\_2021\).pdf](https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/JointCSAIIROCNotice21-329(March29_2021).pdf)
- 28 Securities Act, National Instrument 14-101, B.C. Reg. 48/97, s. 1.1
- 29 CSA Staff Notice 21-327, *Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets* (Jan. 16, 2020), [https://www.osc.ca/sites/default/files/pdfs/irps/csa\\_20200116\\_21-327\\_trading-crypto-assets.pdf](https://www.osc.ca/sites/default/files/pdfs/irps/csa_20200116_21-327_trading-crypto-assets.pdf)
- 30 *Id.* at 1-2.
- 31 *Id.* at 1.
- 32 *Id.* at 1-3.
- 33 *Id.*
- 34 “A security interest may arise due to a number of circumstances, including the use of margin, leverage or financing used to make the purchase.” *Id.* n. 6.
- 35 Notice 21-329.
- 36 *Id.* at 3.
- 37 *Id.* at 4, 7.
- 38 *Id.* at 4, 8.
- 39 *Id.* at 10.

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40 *Id.* at 54.

41 This is because of the way in which the provisions of the EU's MiFID II were implemented into the UK regime prior to Brexit which, at the time of writing, has so far been retained following the UK's withdrawal from the EU.

42 See n [37].

43 Such conditions being that the unauthorised person is not a market maker, does not provide investment services to any person, is not a member or participant of a regulated trading venue (except for non-financial entities who execute transactions on a trading venue which are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of those non-financial entities or their groups) and does not apply a high frequency algorithmic trading technique.

44 <https://financefeeds.com/esma-clarifies-scope-cfd-restrictions-relation-rolling-spot-forex/>

45 "[Glossary: European System of Financial Supervision \(ESFS\)](#)". Deutsche Bundesbank.

46 *Id.*

47 [https://europa.eu/european-union/about-eu/agencies/esma\\_en](https://europa.eu/european-union/about-eu/agencies/esma_en)

48 *Id.*

49 *Id.*

50 <https://www.esma.europa.eu/policy-rules/mifid-ii-and-mifir>

51 *Id.*

52 *Id.*

53 *Id.*

54 *Id.*

55 *Id.*

56 *Id.*

57 <https://perma.cc/A4BP-9QS4>

58 <https://www.esma.europa.eu/press-news/esma-news/esma-consults-potential-cfd-and-binary-options-measures-protect-retail>

59 *Id.*

60 [https://www.esma.europa.eu/sites/default/files/library/esma35-43-1000\\_additional\\_information\\_on\\_the\\_agreed\\_product\\_intervention\\_measures\\_relating\\_to\\_contracts\\_for\\_differences\\_and\\_binary\\_options.pdf](https://www.esma.europa.eu/sites/default/files/library/esma35-43-1000_additional_information_on_the_agreed_product_intervention_measures_relating_to_contracts_for_differences_and_binary_options.pdf)

61 38 Art. 40 of MiFIR permits the ESMA to temporarily prohibit, restrict marketing, distribution, or sale of certain financial instruments on grounds of investor protection and market integrity.

62 *Id.*

63 [https://www.esma.europa.eu/sites/default/files/library/esma35-43-1000\\_additional\\_information\\_on\\_the\\_agreed\\_product\\_intervention\\_measures\\_relating\\_to\\_contracts\\_for\\_differences\\_and\\_binary\\_options.pdf](https://www.esma.europa.eu/sites/default/files/library/esma35-43-1000_additional_information_on_the_agreed_product_intervention_measures_relating_to_contracts_for_differences_and_binary_options.pdf)

64 *Id.*

65 <https://www.coinfirm.com/blog/german-cryptocurrency-regulations/>

66 <https://www.loc.gov/law/help/cryptoassets/germany.php>

67 <https://atozmarkets.com/news/germany-to-ban-derivatives-trading-with-new-tax-law-in-2021/>

68 *Id.*

69 <https://bitcoinexchangeguide.com/italys-securities-regulator-consob-updates-crypto-scam-blacklist-with-unlawful-businesses/>

70 *Id.*

71 *Id.*

72 <https://blog.blockpit.io/en/crypto-taxation-regulations-spain>

73 *Id.*

74 *Id.*

75 <https://cryptopotato.com/spain-seeks-public-comments-on-potential-cryptocurrency-regulations/>

76 *Id.*

77 <https://cryptoinlaw.com/france-cryptocurrency-regulation/>

78 *Id.*

79 <https://www.loc.gov/law/help/cryptocurrency/france.php>

80 <https://www.amf-france.org/en/news-publications/news-releases/amf-news-releases/amf-considers-offer-cryptocurrency-derivatives-requires-authorisation-and-it-prohibited-advertise>

81 <https://coinshares.com/research/crypto-concerns-regulations>

82 *Id.*

83 <https://www.loc.gov/law/help/cryptocurrency/switzerland.php>

84 *Id.*

85 *Id.*

86 *Id.*

87 *Id.*

88 <https://apps.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=17PR147>.

89 First, the SFO defines "futures contract" to mean:

(a) A contract or an option on a contract made under the rules or conventions of a futures market;

(b) Interests, rights of property which is interests, rights or property, or is of a class or description of interests, rights or property, prescribed by notice under section 392 of this Ordinance as being regarded as futures contracts in accordance with the terms of the notice,  
But the term does not include “interests, rights or property which is interests, rights or property, or is of a class or description of interests, rights or property, prescribed by notice under section 392 of this Ordinance as not being regarded as futures contracts in accordance with the terms of the notice.

Note also that, under the SFO, “futures contracts” are considered a “financial product.”

Second, the SFO defines “futures market” as “a place at which facilities are provided for persons to negotiate or conclude sales and purchases of, or for bringing together on a regular basis sellers and purchases of---

- a. contracts the effect of which is—
  - i. that one party agrees to deliver to the other party at an agreed future time an agreed property, or an agreed quantity of a property, at an agreed price; or
  - ii. that the parties will make an adjustment between them at an agreed future time according to whether at that time an agreed property is worth more or less or an index or other factor stands at a higher or lower level than a value or level agreed at the time of making of the contract; or
- b. options on contracts of the kind described in paragraph (a),

Where (i) the contracts or options of the kind described in paragraph (a) or (b) are novated or guaranteed by a central counterparty under the rules or conventions of the market on which they are traded; or (ii) the contractual obligations under the contracts or options of the kind described in paragraph (a) or (b) are normally discharged before the contractual expiry date under the rules or conventions of the market on which they are traded, but does not include the office of a recognized clearing house..”

90 SFC, SFC issues warnings on virtual asset futures contracts (Nov. 6, 2019), <https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/SFC-issues-warnings-on-virtual-asset-futures-contracts>.

91 See SFC, *Circular to Licensed Corporations and Registered Institutions on Bitcoin futures contracts and cryptocurrency-related investment products* (Dec 11, 2017) (“Bitcoin Futures have the conventional features of a “futures contract” which is defined in the Securities and Futures Ordinance (“SFO”) to include “a contract or an option on a contract made under the rules or conventions of a futures market”. Therefore, even though the underlying assets of Bitcoin Futures are not regulated under the SFO, Bitcoin Futures traded on and subject to the rules of those exchanges are regarded as “futures contracts” for the purposes of the SFO.”) [Announcement - re: Mr Chim Pui Chung and Mandarin Resources Corporation Limited \(available as Acrobat file\) | Securities & Futures Commission of Hong Kong](https://www.sfc.hk/edistributionWeb/api/circular/openFile?lang=EN&refNo=17EC79).

92 <https://apps.sfc.hk/edistributionWeb/api/circular/openFile?lang=EN&refNo=17EC79>.

93 <https://apps.sfc.hk/edistributionWeb/api/circular/openFile?lang=EN&refNo=17EC79> (footnote 2).

94 See Part 1 of Schedule 5 to the SFO.

95 [SFC issues warnings on virtual asset futures contracts](https://www.sfc.hk/edistributionWeb/api/circular/openFile?lang=EN&refNo=17EC79).

96 See [https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult\\_conclu\\_amlo\\_e.pdf](https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_conclu_amlo_e.pdf). Note that the FSTB must still prepare an amendment bill to the AMLO, drawing from the conclusions established in this public statement, and introduce the bill to the Legislative Council in the 2021-2022 legislative session. It’s expected that the new regulatory regime will be adopted by the Legislative Council and commence in 2022, providing market participants a 180 days transition period to comply with new restrictions.

97 See [https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult\\_conclu\\_amlo\\_e.pdf](https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_conclu_amlo_e.pdf). Note that the FSTB stated that “the presence of VA activities conducted outside VA exchanges is scanty and negligible in Hong Kong...”

98 [https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult\\_conclu\\_amlo\\_e.pdf](https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_conclu_amlo_e.pdf) (“As the VA industry is an emerging sector involving higher risks than conventional financial markets, the requirement of confining the services of a VA exchange to professional investors only is necessary to ensure a proper degree of protection for the investing public, in line with the policy objective of promoting the healthy and orderly development of the market.”)

99 Specifically, “professional investors” include high net-worth individuals with a portfolio of at least HK\$8 million; corporations with portfolios of at least HK\$8 million or total assets of at least HK\$40 million; or institutional investors such as licensed banks, broker-dealers, and asset managers. For the purposes of the portfolio/assets classification, virtual asset holdings are excluded and only securities and certain deposits are counted. See <https://www.jdsupra.com/legalnews/hong-kong-confirms-new-regulatory-7311574/>.

100 <https://www.jdsupra.com/legalnews/hong-kong-confirms-new-regulatory-7311574/>.

101 [https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult\\_conclu\\_amlo\\_e.pdf](https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_conclu_amlo_e.pdf).

102 [https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult\\_conclu\\_amlo\\_e.pdf](https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_conclu_amlo_e.pdf).

103 <https://www.jdsupra.com/legalnews/hong-kong-confirms-new-regulatory-7311574/>.

104 See <https://www.fintechandpayments.com/2019/11/hong-kong-fintech-week-day-1-in-review/>.

105 See <https://www.jdsupra.com/legalnews/hong-kong-confirms-new-regulatory-7311574/>.

106 See [https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult\\_conclu\\_amlo\\_e.pdf](https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_conclu_amlo_e.pdf).

107 The definition also excludes certain “closed-loop, limited purpose items” which the FSTB intends to cover “non-transferable, non-exchangeable and non-fungible in nature [items], such as air miles, credit card rewards, gift cards, customer loyalty programmes and gaming coins...” See [https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult\\_conclu\\_amlo\\_e.pdf](https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_conclu_amlo_e.pdf).

108 See [https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult\\_conclu\\_amlo\\_e.pdf](https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_conclu_amlo_e.pdf).

109 Crypto Assets are defined in the amended PSSA. See Article 2, Paragraph 5. This definition would appear to cover most exchange-traded tokens/crypto-assets, that is, most underlying assets in crypto-derivatives

contracts. **Exception:** digital tokens whose transfer is restricted by the issuer (via, for instance, a smart k) so as to prevent satisfying element (i) above. Another exception might be **stablecoins** which might qualify as assets whose value is denominated in fiat currency.

110 See Article 2, paragraph 24, subparagraph 3-2 of the amended FIEA.

111 Prior to the 2019 Amendment, crypto currency derivative transactions were not subject to derivative regulations under the FIEA. The 2019 Amendment plugged this hole, bringing crypto derivatives into FIEA's coverage by adding 'Crypto Assets' to the list of "Financial Instruments" that underlie assets of derivative transactions and are subject to derivative regulations under the FIEA. See Article 2, paragraph 24, subparagraph 3-2 of the amended FIEA.

112 Article 2(24)(iii-2) FIEA.

113 Article 2(20) FIEA.

114 Type I crypto assets are defined as property value that can be (i) used with unspecified persons for purchasing goods or services, (ii) purchased from and sold to unspecified persons acting as counterparty, and (iii) transferred electronically. Article 2(5)(i) PSA.

115 Type II crypto assets are property values that can be (i) mutually exchanged with type I crypto assets with unspecified persons acting as a counterparty and (ii) transferred electronically. Article 2(5)(ii) PSA.

116 Article 2(5) PSA.

117 See Article 2(24).

118 See Article 2(21)(i), Article 2(22)(i).

119 See Article 2(21)(iii), Article 2(22)(iii).

120 See Article 2(21)(ii), Article 2(22)(ii).

121 See Article 2(21)(iii), Article 2(22)(iii).

122 See Article 2(21)(iii)(b), Article 2(22)(iv).

123 See Article 2(21)(iv), Article 2(22)(v).

124 See Article 2(21)(iv)-2.

125 See Article 2(21)(v), Article 2(22)(vi).

126 [https://www.fsa.go.jp/en/laws\\_regulations/faq\\_on\\_fiea.pdf](https://www.fsa.go.jp/en/laws_regulations/faq_on_fiea.pdf).

127 See Article 2(8) of the FIEA.

128 Article 2(20) of the FIEA.

129 Article 2(8)(i)-(iv) of the FIEA.

130 See Article 28(1)(i) and (ii) of the FIEA. See also [https://www.fsa.go.jp/en/laws\\_regulations/faq\\_on\\_fiea.pdf](https://www.fsa.go.jp/en/laws_regulations/faq_on_fiea.pdf).

131 See Article 28(2)(ii) and (iii). See also [https://www.fsa.go.jp/en/laws\\_regulations/faq\\_on\\_fiea.pdf](https://www.fsa.go.jp/en/laws_regulations/faq_on_fiea.pdf).

132 There is no exemption from the requirement to register as a Type 1 Financial Instrument Business Operator for Crypto Asset-related derivatives for trading solely with professionals. However, a limited exemption exists for foreign service providers that legitimately operate Crypto Asset derivatives business in its home jurisdiction that solely trade with Japanese professionals operating solely outside Japan.

133 Article 31, Paragraph 3 of the amended FIEA and Article 20-2 of the amended Cabinet Office Ordinance Concerning Financial Instrument Business Operators, etc. <https://www.mofa.com/resources/insights/200423-japanese-cryptocurrency-update.html>.

134 The term "**Crypto Asset Exchange Services**" means any of the following acts carried out as a business:

- The sale and purchase of crypto-asset or exchange of crypto-asset for other crypto-assets.
- Being an intermediary, brokerage or delegation of the acts listed above.
- The management of users' money in connection with the acts listed above.
- The management of crypto-asset for the benefit of another person.

136 Security tokens are excluded from the term "Crypto Assets" by definition. See Article 2, Paragraph 5 of the PSA.

137 Specifically, security tokens made non-transferrable to persons other than qualified investors, perhaps via smart contract. If so, then the less stringent Type 2 Financial Instrument Business categorization applies.

138 Potential unfair practices include:

- engaging in fraudulent sales/purchases;
- engaging in collusive sales/purchases;
- custody/accepting the custody of fraudulent sales/purchases or collusive sales/purchases;
- engaging in market manipulation via 'real' sales/purchases (i.e. cartels); or
- engaging in market manipulation via 'perceived' representations.

See Article 185-22 to Article 185-24 of the FIEA.

139 Article 2(8)(iv) FIEA.

140 Articles 28(1)(ii), 29 FIEA.

141 Article 1-8-6(1)(i) FIEA Enforcement Order.

142 See also IV-3-3-1(3) FIBO guidelines.

143 See Article 2(8) FIEA (defining financial instruments business).

144 Art. 117(51) and (52) Cabinet Order on Financial Instruments Business.

145 Article 2(7) PSA.

146 Article 63-5(iv) and (v) PSA, Cabinet Order on Crypto Asset Exchange Service Providers.

147 See Article 2, paragraphs 7 and 8 of the amended PSA.

148 Article 83-2 FIEA.

149 Article 97 FIEA.

150 Article 83-2 FIEA, Article 19 Order for Enforcement of the FIEA.

151 See Article 2, Paragraph 7, Item 4 of the amended PSA (stating that the provision of Crypto Asset custody services is “the business to be engaged in administration of Crypto Assets for third parties.”). In the amended Administrative Guidelines (Book 3: Concerning Financial Service Companies; Chapter 16 Crypto Asset Exchange Service Providers), known as the “PSA Guidelines,” states that “if the service provider holds private keys sufficient for transferring the customer’s Crypto Assets for itself or together with its sub-contractor or related service provider, or can otherwise transfer in its initiative the customer’s Crypto Assets without the involvement of the customer, such service provider is considered as engaged in the administration of Crypto Assets for third parties” and thus has to be registered as a Crypto Asset Exchange Service Provider under the PSA.

152 *Id.*

153 Note that under the 2019 Amendment, to register as a Crypto Asset Exchange Service Provider, holders of 10% or greater of the voting rights in the applicant must be disclosed to the JFSA. See Article 5, Item 3 and Article 8 of the draft amendments to the Cabinet Office Ordinance Concerning Crypto Asset Exchange Service Providers (“PSO Ordinance”).

154 <https://www.pwc.com/jp/en/legal/news/assets/legal-20190425-en.pdf>.

155 See Article 27, Paragraph 3, Item 1 of the PSA Ordinance (defining “cold wallets and equivalents”). Note that the regulations go into greater detail in how cash is maintained (such as in a trust account opened with a license trustee, etc.). Chief among the requirements is a daily obligation to compare the aggregate amount of customer cash held (by the Crypto Asset Exchange Service Provider) with the outstanding amount of trust assets and—if there is a shortfall—must adjust the amount of the trust assets within two business days to equal or exceed the value of customer cash.

156 Article 27 of the PSA Ordinance.

157 <https://www.mas.gov.sg/news/parliamentary-replies/2020/reply-to-parliamentary-question-on-regulation-of-crypto-derivatives-on-approved-exchanges>

158 <https://www.mas.gov.sg/regulation/faqs/faqs-on-product-definitions>

159 Under Article 5 of the FSCMA, the term “derivatives” is defined as any of the following contractual rights:

1. A contract in which it is agreed to deliver money, etc. at a certain point in the future, which shall be computed on the basis of underlying assets, the price of the underlying assets, an interest rate, an indicator, a unit, or an index based on any of the aforesaid factors;
2. A contract in which the parties agree to grant, by either party's unilateral expression of willingness, a right to effectuate a transaction of delivering and accepting money, etc., which shall be computed on the basis of underlying assets, the price of the underlying assets, an interest rate, an indicator, a unit, or an index based on any of the aforesaid factors;
3. A contract in which the parties agree to exchange money, etc. which shall be computed on the basis of underlying assets, the price of the underlying assets, an interest rate, an indicator, a unit, or an index based on any of the aforesaid factors, during a certain period in the future at a predetermined price;
4. A contract prescribed by Presidential Decree, which is similar to contracts referred to in subparagraphs 1 through 3.

(Provided, [sic] that the term shall not apply to financial investment instruments prescribed by Presidential Decree as appropriate to regulate them as securities taking into consideration the possibility of circulation, parties to contracts, grounds for issuance, etc. of the relevant financial investment instruments).

The term “exchange-traded derivatives” in this FSCMA means any of the following derivatives:

1. Derivatives traded in the domestic derivatives market;
2. Derivatives traded in an overseas derivatives market (referring to a market in a foreign country, which is similar to the domestic derivatives market and a market where foreign derivatives prescribed by Presidential Decree are traded);
3. Other derivatives are traded in the financial investment instruments market in accordance with the standards and methods determined by a person who has opened and operates the financial investment instruments market.

The term “over-the-counter derivatives” in this Act means the derivatives that are not exchange-traded derivatives. (4) The execution of a contract that falls within any of the subparagraphs of paragraph (1) which is not a sales contract, shall be deemed a sales contract for the purposes of this Act.

160 See, e.g., [Breaking Down What South Korea's Crypto Crackdown Means for the Industry](#).

161 Adding greater confusion is the fact that Korea’s Financial Supervisory Service announced in 2017 that it did not consider cryptocurrencies (i) fiat currencies; (ii) prepaid electronic means or electronic currencies; or (iii) financial investment instruments, without providing clarity as to what legal status it thought cryptocurrencies are.

162 FATF, “International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations,” at 14-15 (updated June 2021) (“FATF Recommendations”).

163 FATF Recommendations (2021), at 123.

164 FATF Recommendations (2021), at 130.

165 FATF Second 12-Month Review of the Revised FATF Standards on Virtual Assets and Virtual Asset Providers, July 2021, executive summary

166 31 USC 5318(1) (BSA); 17 CFR Sec. 42.2 (CFTC regulation applying BSA requirements to FCMs and IBs).

167 For instance, see In the Matter of the Application of LedgerX, LLC for Registration as a Derivatives Clearing Organization, Amended Order of Registration, para. 8 (Sept. 2, 2020).; In the Matter of the Application of Eris

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Clearing, LLC For Registration as a Derivatives Clearing Organization, Order of Registration, para. 9 (Nov. 2, 2020).

<sup>168</sup> 31 CFR Sec. 1010.100(t).

<sup>169</sup> See *United States v. Hayes, et al.*, Case No. 20 Cr. 500 (S.D.N.Y. 2020) (indictment); U.S. Comm. Futures Trading Comm. V. HDR Global Trading Ltd., et al., Case No. 1:20-cv-08132 (S.D.N.Y. 2021) (Consent Order for Permanent Injunction).

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