
Hong Kong's growing appeal amongst issuers stems from its strengthening support ecosystem for the development of blockchain

Hong Kong's ICO proceeds hit $223m

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Roughly a year since China moved to ban all initial coin offerings, also known as token sales, Hong Kong has enjoyed a surge of issuers and has gathered momentum as a top ICO centre in Asia. Whilst the territory still trails Singapore in overall activity and concerns remain on token sales that turn out to be scams, analysts and industry players observe progress in regulatory clarity, issuer quality, and investor education that should help drive growth in the coming years.

In September 2017, the People's Bank of China, the country's central bank, banned all ICOs, criticising its disruptive effect on the country's financial system and calling it "a form of unapproved illegal public financing." It also forbid all financial institutions and non-bank payment institutions from conducting any business related to token financing transactions, as the world's second-biggest economy continues its campaign to reduce risky lending.

The China ban has led issuers to flock to Hong Kong, which has emerged as one of the most favourable countries in Asia for ICOs. The territory was one the top 10 countries in 2018 for ICOs based on funding volume, with $223m raised across 20 closed ICOs and 15 more in the pipeline, according to a joint report in June by PwC and Crypto Valley Association, an independent and Swiss government-supported industry body.

"Across Asia, Singapore is the main ICO hub, followed by Hong Kong," the PwC and Crypto Valley report said, noting that the territory has "gained significant ground" in recent months to catch up to leaders like the US and Switzerland. Hong Kong still lags significantly behind Singapore—which placed top three in the 2018 rankings, with $1.19b raised across 53 closed ICOs and 52 additional in the planning stages—but the territory's entry to the top 10 rankings shows it is gaining some steam.

Fusion Foundation, a startup building an "inclusive cryptofinancial platform," raised US$110m.

Aside from benefiting from the exodus of issuers from mainland China following the ban, Hong Kong's growing appeal amongst issuers stems from its strengthening support ecosystem for the development of blockchain, cryptocurrencies, and ICOs, according to analysts and industry players.

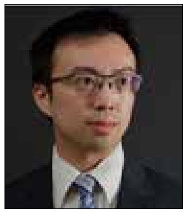
"Over the past 12 months, we have seen many industry-led best practice initiatives where the ecosystem has come together to agree on best practices that many want to follow," said **Henri Arslanian**, PwC fintech & crypto lead for Asia and chairman of the FinTech Association of Hong Kong, citing the best practice guides launched by the FinTech Association of Hong Kong for ICOs and the Asia Securities Industry & Financial Markets Association for cryptocurrency exchanges.

There has also been greater regulatory clarity in the past year. Hong Kong's Securities and Futures Commission in September 2017 issued a statement specifically on ICOs on how they are regulated under the territory's securities laws, providing greater clarity for issuers and token holders.

"The statement clarifies that not all digital tokens are necessarily securities, but where the tokens are, in substance, a share, debenture, or interest in collective investment scheme and are being offered to the Hong Kong public, the securities and prospectus regimes in Hong Kong will need to be considered," said Slaughter and May's **Roger Cheng** in a note after the statement's release. "The approach taken by the SFC follows the approaches adopted by the US and Singapore regulators (with the key exception of mainland China which has banned ICOs) and shows an emergence of a global consensus on how to regulate ICOs."

Like in Hong Kong, other regulators are weighing their regulatory approach as ICO activity continues to soar. ICO volumes reached new highs in the first half of 2018, amounting to already twice as much as it was during the entire year of 2017, according to CoinTelegraph. Reports of scams and increasing concerns to protect investors have also been key factors in how regulators are navigating the new ICO frontier.

Henri Arslanian



Roger Cheng

Jack Cheng

Greater compliance focus

Industry players noted that amidst the clearer guidelines and greater investor scrutiny amongst the raft of available ICOs, issuers have shifted gears and are paying more attention to compliance and business longevity. "In the past, people are in fear-of-missing-out stage and contributions flowed into token sales regardless of their nature, market impact, and long-term potential business growth. It's easy to hear some sort of golden formula to make a token sale successful: a stunning website, a project explanation video, a white paper, a cool mixture of advisors, plus community marketing. The situation has changed," said **Jack Cheng,** managing director of MegaBlock.

"Projects nowadays pay much attention to compliance and regulation, a detailed technical white paper to explain from a technical perspective, and sometimes a prototype or workable alpha release of applications before going into token sales," he said, noting that more token holders are starting to evaluate projects on a long-term perspective rather than speculative. "At the end of the day, deliverability is more important than a fancy idea. This is the key for a project to be successful in the long-run."

In 2017, over $5.6b was raised through token sales, not to mention "some from unrecorded private and over-the-counter contribution," as well as thousands of different tokens being generated, according to Jack Cheng. He said regulators have stepped up their rules surrounding ICOs in response to the bad eggs in the burgeoning basket, and the regulatory tightening could be viewed as a positive for the industry as a whole.

"Some companies or projects leverage multi-level marketing schemes to capture the money from mass market; they do good marketing to generate interests, but not really deliver the true value in terms of technology," said Jack Cheng. "These are so-called scam projects around the market and that is one of the reasons why regulation has to come in apart from anti-money laundering, tax, and remittance concerns."

"Having said that, token sales could be seen as a new and efficient way for start-up company to raise funds their projects, products, and services. Regulations actually is a good thing for the industry. Real projects and companies that deliver true value are able to stay in the market whereas scam projects will be wiped out," he added.

Arslanian said that whilst there are many cryptocurrency companies aiming to build game-changing business for the long term, "there are unfortunately still some bad apples that are trying to make a quick buck."

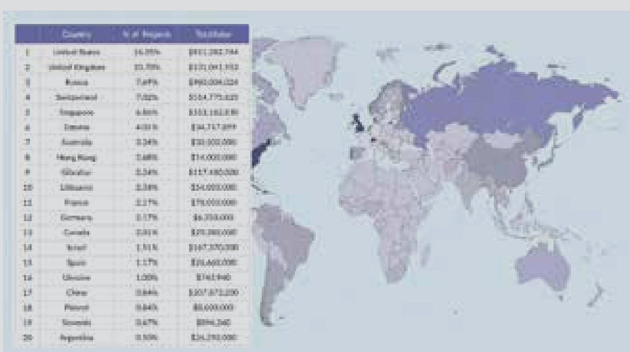
Due to growing regulatory scrutiny, the legal aspects of token sales are becoming increasingly important, especially with regards to the rights which attach to tokens, as well as anti-money laundering/know-your-customer and corporate governance matters, ASIFMA noted in its best practice guide for digital asset exchanges. "In order to ensure credibility of a token sale event and its anti-money laundering/counter-terrorism financing compliance, issuers increasingly put in place mechanisms to comply with securities and other laws, verify purchaser's identities and/or exclude investors from certain jurisdictions," the association said.

Roger Cheng noted that given the potential criminal liabilities, including imprisonment, for breaches in Hong Kong's securities law, "parties involved in ICOs cannot simply treat this as a 'grey area' of law and should consider obtaining regulatory advice when planning or developing ICOs and virtual token projects going forward." The SFC has warned it will be monitoring the market and will be on the lookout for ICOs and exchanges that would require some regulatory oversight.

Trust and credibility

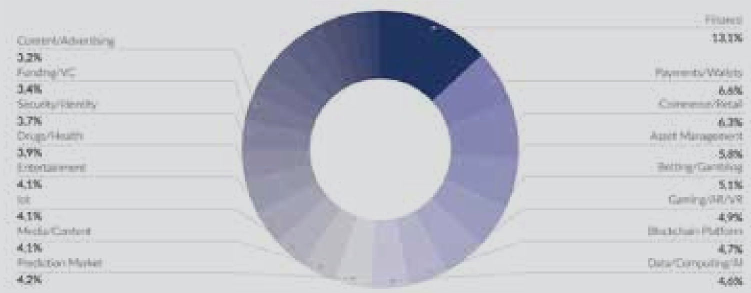
Whilst ICOs are continuing to rise in popularity, there are vocal criticisms both from regulators and token holders, including the sustainability of ICO businesses. "Projects that fizzled out may have many reasons such as the insufficiency of market validation, regulation of token economy model, lack of the ability for user acquisition or business penetration, or technical development capacity," said Jack Cheng. "Apart from that, the deliverability is the most important key to success. To do that, it requires not just technical expertise, but also multiple sets of skills,

Biggest ICO raisers by country



Source: icowatchlist

Number of projects by categories, %



Source: icowatchlist

including but not limited to business operation control, marketing, and people management."

Jack Cheng stressed that at the heart of ICOs, the real value lies in the people and working together to achieve the goals. "A correct team matrix will contribute a lot towards the milestones. In addition, the culture of competition is good to see in the blockchain industry," he said.

Arslanian noted a "significant" improvement in quality and professionalism of crypto projects in the past 12 months. "Today, most projects we see have experienced management teams, well thought through business models and an institutional mindset. This was not the case in the early days of the ICO craze," he said.

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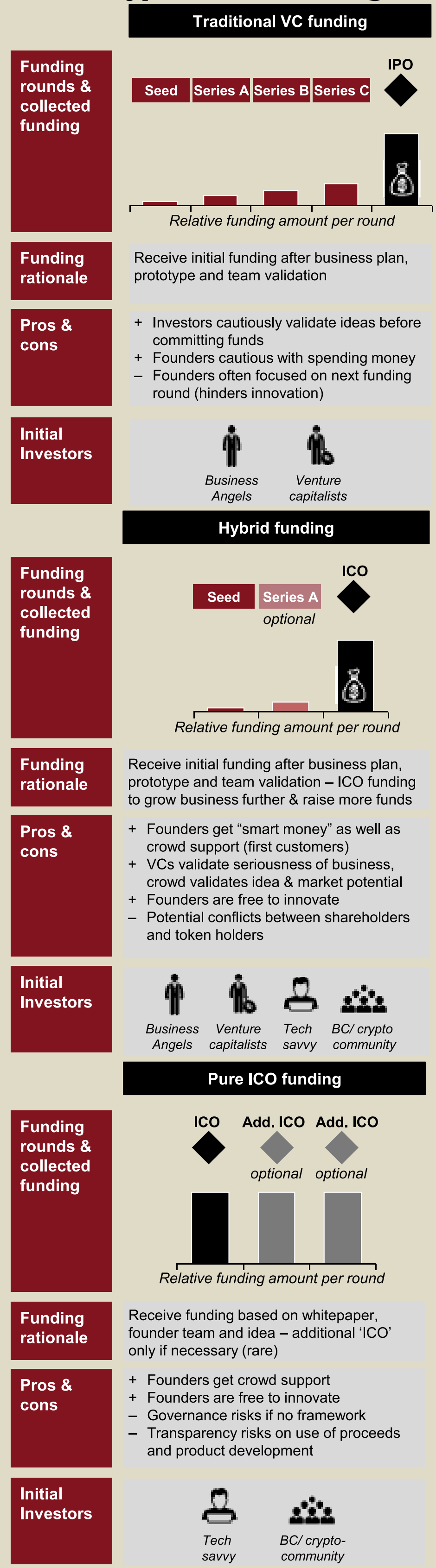
Other key trends

Key trends shaping the sector include Hong Kong venture capital firms also getting in on the ICO game, such as GSR Capital agreeing in June to purchase $160m worth of tZero security tokens, which run on the Ethereum blockchain. Whilst the tokens do not constitute company equity and do not confer any voting rights, they pay out dividends to investors at a rate of 10% of tZero's adjusted gross revenue on a quarterly basis from tZero's regulated trading platform, which will list ICO tokens and other blockchain-based securities. tZero said that it has obtained $168m worth of token sale commitments, which when combined with GSR Capital's investment, brings its total fundraising to $328m, exceeding the $250m it had targeted when it first filed to inform the US Securities and Exchange Commission of the offering. The HKMA is also set to launch a live blockchain-based trading platform in September, which could further support the local environment for ICO issuers.

Jack Cheng also noted the potential of Initial Token Distribution as an alternative way to manage the token economy. "The main purpose of token sales is fundraising. In certain extents, it may not unleash the true potential of the project if the token sales fall into a small group of investors and there is no significant amount of utility token holders there to consume the token for the products or services," he said. The goal is to trigger network effect and boost awareness, with the monetary value coming in the later stage. "Because of the giveaway nature, it also helps the project to lower the associated compliance risks in some jurisdictions," Jack Cheng added.

New archetypes of fundraising



Source: PWC