Potential of the Crypto Market In China

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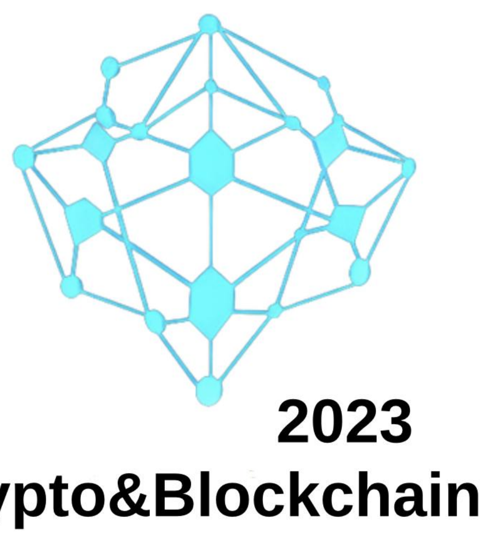

Abstract

This paper provides an overview of cryptocurrencies, their current status in China and Hong Kong, a prediction of their impact on Chinese enterprises and financial markets, and describes the impact of government policies. It also discusses suggestions for changing the regulatory paradigm of digital cryptocurrencies in China. The study aims to explore the best policy direction for the development of the cryptocurrency market in mainland China. Key points include the strict stance of the Chinese government towards cryptocurrencies, the growing interest in cryptocurrencies in Hong Kong, and the impact of government policies on the cryptocurrency market in both regions. It also highlights the need for China to adjust its policies to benefit from the development of digital technology. Additionally, it suggests policy recommendations for the future development of the cryptocurrency market in mainland China, such as prudent supervision, technology-driven supervision, and strengthening the security requirements of digital cryptocurrency service providers.

Keywords: Cryptocurrencies, China, Hong Kong, impact, government policies, regulatory paradigm, digital technology, prudential supervision, technology-driven supervision, security requirements, development direction

1 Cryptocurrencies in China and Hong Kong

1.1 Definition

A cryptocurrency is a form of money that exists digitally or virtually and uses cryptography to protect transactions. A cryptocurrency does not have a central issuing or regulatory body, but instead uses a decentralized system to record transactions and issue new units.

1.2 Current status

1.2.1 Regulation and Status

In mainland China, the government has taken a relatively strict stance towards cryptocurrencies. In 2017, China banned initial coin offerings (ICOs) and cryptocurrency exchanges, leading to a significant decline in local trading activities. The ban was primarily implemented to control capital outflows, prevent fraud, and maintain financial stability. However, it's worth noting that while centralized exchanges are banned, peer-to-peer trading and over-the-counter (OTC) markets still exist. In contrast, Hong Kong has a more lenient regulatory environment. Cryptocurrencies are not considered legal tender, but they are not entirely banned either. The Hong Kong government has adopted a "wait and see" approach, monitoring the market while ensuring investor protection. Cryptocurrency exchanges can operate in Hong Kong as long as they comply with anti-money laundering (AML) and know-your-customer (KYC) regulations.

1.2.2 Market Trends

According to recent reports, Hong Kong has been witnessing a growing interest in cryptocurrencies. The city's proximity to mainland China and its reputation as an international financial hub have attracted several blockchain and cryptocurrency companies. Hong Kong also hosts various blockchain conferences and events, which further contribute to the cryptocurrency ecosystem. In mainland China, while the ban on centralized exchanges remains, there are still active crypto communities and activities. Peer-to-peer trading platforms and OTC trading have gained popularity, allowing individuals to trade cryptocurrencies indirectly.

1.3 Prediction of the Impact of Cryptocurrencies on Chinese Enterprises.

As the initial coin offering (ICO) of a digital currency has gradually become an important way for many blockchain projects to raise funds in the early stage, cryptocurrencies have financing functions. Considering the typical securities characteristics of cryptocurrencies, such as profitability, risk, readability, and equal equalization, cryptocurrencies can be defined as a type of decentralized security or decentralized financing model. Therefore, the widespread use of cryptocurrencies can expand investment and financing channels. Enterprises will issue corporate tokens to attract potential investors to purchase digital cryptocurrency units, and finally give units back to investors, which may benefit them. In the process, businesses acquire digital cryptocurrency units that can be exchanged for fiat currency through trading platforms to raise funds. The model is known as token issuance financing. Companies can bypass complex international scrutiny and do not need specific trading platforms, a model that helps many SMEs with financing problems.[11]

1.4 Predicted impact on financial markets.

1. Avoid legal currency risks. Against the background of world economic integration, once a financial crisis, war, economic sanctions, and so on occur, the legal tender will depreciate and the value of the currency held by the people will shrink. Digital cryptocurrencies that are privately issued have natural advantages in dealing with the problem of legal tender, can be traded when the parties agree, and have a global market. Moreover, their price fluctuations are only related to the market, so when the fiat currency is inflated or there is a credit crisis, the digital cryptocurrency is not affected at all and has a good store of value.

2. Reduce the cost of international commercial transactions. Under the premise of world economic integration, international commercial transactions are often settled in US dollars, but the foreign exchange control authorities review the flow of funds for international transactions quite strictly, which invisibly increases the time and currency costs of international transactions. Digital cryptocurrencies use peer-to-peer transactions to directly remit the amount to the recipient's digital cryptocurrency account to simplify the transaction process. The parties to the transaction can complete the transaction directly with a digital cryptocurrency, or they can introduce a digital cryptocurrency platform, and the recipient can choose whether to directly receive a digital cryptocurrency or national legal tender.

3. Promote the disclosure of transaction information. UnionPay is China's transaction clearing system, storing all transaction information, and the transaction information of the clearing and settlement system is hidden and unknown to outsiders. There is no national credit to endorse, and all transaction information is P2P. Any transaction must be uploaded to the blockchain to achieve the effect of public trust, and the user's personal information is encrypted.

1.5 The impact of government policies on the cryptocurrency market in mainland China and Hong Kong.

1.5.1 Hong Kong

Crypto-assets have traditionally been regulated by the Securities and Futures Commission (SFC) under the existing securities law framework. Over the years, the SFC has displayed a rather cautious stance towards crypto-assets and adopted a piecemeal approach to dealing with the regulatory issue. As the crypto-asset market grows, this piecemeal approach has become increasingly inadequate as evidenced by the issues of regulatory gaps and regulatory arbitrage.[3]

In Hong Kong, crypto-assets do not qualify as money and are not regulated as legal tender by the Hong Kong Monetary Authority (HKMA). Prior to the introduction of the 2018 Statement on Regulatory Framework, crypto-assets had generally been regulated by the SFC under existing securities laws.

On 5 September 2017, the SFC issued a statement to the effect that under the Securities and Futures Ordinance (Cap 571) (SFO) crypto-assets may constitute a 'security' based on their terms and features, and parties engaging in a 'regulated activity' associated with securities must be licensed or registered with the SFC, so long as such activities target the Hong Kong public.[7]

On 11 December 2017, regulation was extended to cover derivatives of crypto-assets falling under the definition of 'securities' and 'futures contracts' (SF crypto-assets).

Furthermore, the extension of notification requirements to all crypto-assets on 1 June 2018 highlighted the SFC's growing concern with regard to the effectiveness of intermediaries in discharging their gatekeeping function, and the lack of regulation over crypto-assets which are not regarded as 'securities' or 'futures contracts' (non-SF crypto-assets).[1]

Owing to the growing concerns of investor protection, on 1 November 2018 the SFC issued the Statement on Regulatory Framework for Virtual Asset Portfolios Managers, Fund Distributors, and Trading Platform Operators (2018 Statement on Regulatory Framework). This is the first time that the SFC has issued a special rule on crypto-assets, representing a significant development in the regulatory approach towards crypto-assets in Hong Kong.[9]

As discussed above, the work of the new regime in Hong Kong represents great efforts made to regulate crypto-assets, addressing the lacunas that existed in the preceding framework.

1.5.2 In China

To start with, the choice of regulation over prohibition is a sensible one, and the new SFC regime should be a welcoming move for the Hong Kong crypto-asset market. While the majority of overseas jurisdictions have embraced crypto-asset business activities and put forth regulatory responses, jurisdictions such as Mainland China have gone the opposite way in banning crypto-assets altogether.[6]

Having declared crypto-assets to be without legal status as fiat currency, Mainland China has all along adopted a considerably cautious and skeptical approach.

In 2013, the central bank issued the Notice on Preventing Bitcoin Risks, which mainly targets money laundering crimes and financial risks using Bitcoin. It is clearly pointed out that bitcoin shall not be circulated and used in the form of currency in China, the trading platform must be recorded, and there are no clear restrictions and regulations on the entry threshold of the trading platform and the technical security of the network.[7]

In September 2017, the central bank issued the "Announcement on Preventing Risks in Token Issuance and Financing". The Announcement continues the regulatory philosophy of the Circular, characterizing the financing of issuing corporate tokens to raise cryptocurrencies as illegal, and trading platforms have also moved from filing directly to prohibiting entry qualifications. So far, China has adopted a comprehensive ban model for digital cryptocurrencies. China has adopted a model of total prohibition for digital cryptocurrencies.

In August 2017, the State Council clearly put forward guidance on the pilot application of new blockchain-based technologies, which represents the encouragement of the development of blockchain technology. In 2022, the digital yuan pilot has been extended to the Winter Olympics scenario. China's attitude of actively developing the digital yuan has driven the research of digital cryptocurrencies to a certain extent.[10]

This policy of a comprehensive ban, in the era of the digital economy, may result in China missing the fintech innovation brought by digital cryptocurrencies. Secondly, the explicitly prohibited policy may allow some users and platforms to enter the underground market to trade, and the more irregular the underground market, the greater the risk. Finally, digital cryptocurrencies are international, China's prohibition model cannot prevent other countries from recognizing or even supporting them, and China's prohibition model is relatively passive.[8]

Therefore, we believe that the government should adopt a regulation Instead of a prohibition attitude towards the development of the cryptocurrency market, and from this, we can make recommendations on future policies of the Chinese government in related fields.

1.6 China's digital cryptocurrency legal regulatory paradigm change suggestions.

1.6.1 Prudential supervision of digital cryptocurrencies

1. **"Sandbox regulation" attempt.**
   The "sandbox regulation" model can be used for trials in small areas, where regulators can test the safety of the trading environment through technical means and set up experimental incentive mechanisms, such as entering competition and optimizing rewards and punishments. Govern-

ments could observe the results of the sandbox, and finally decide whether to push it to most regions. The adoption of the sandbox regulation can effectively prevent the spillover of risks and be conducive to the stability of the financial market.

2. **Technology-driven supervision.**[5]
   Digital cryptocurrency technical standards can be established for supervision in accordance with guidelines, early risk warning, risk assessment, and risk regulation measures when maintaining information security. To obtain significant technical force, it requires the government to cooperate with other states to form more effective and unified regulatory technical standards and to adopt the most advanced technology in the industry to regulate digital cryptocurrencies.

   For example, Fraud in the securities market, such as market manipulation and insider trading, has caused serious damage to the market order and the interests of investors. The application of deep learning technology in fraud detection in the securities market mainly includes the identification of abnormal trading behavior and the analysis of market manipulation behavior. Through the deep learning of multi-source data such as transaction data and market information, the potential rules of fraud such as market manipulation and insider trading can be mined out.

   Establish an insurance system for digital cryptocurrency service providers. When the platform loses or goes bankrupt, how to maximize the protection of the interests of the platform users is under discussion. It is difficult to mitigate losses through the reserves and guarantees due to the regulatory authorities. At the same time, raising the platform access threshold will cause an unreasonable increase in the cost of service providers, seriously affecting the development of the industry.

   In this case, establishing an insurance system for digital cryptocurrency service providers has certain advantages. By introducing third-party insurance, the transaction security risk of digital cryptocurrency service providers can be transferred to the insurance company. Insurance companies, as the designers of insurance products, can communicate with various digital cryptocurrency service providers and professionally evaluate them to intervene in the platform's supervision, strictly prohibiting illegal operations. The service providers can also avoid the drastic turbulence of digital cryptocurrencies and buffer the market to a certain extent.

1.6.2 Strengthen the security requirements of digital cryptocurrency service providers[2]

1. **Improve transaction security**
   In terms of active supervision, we can reasonably classify the operators, explore the way of intelligent supervision, and try to write the regulatory rules into the blockchain system, use blockchain technology to automatically regulate the compliance of the system.

2. In terms of information disclosure, service providers shall establish customer identification procedures and illegal transaction blocking procedures, review the legal compliance related to transactions, and regularly submit quarterly financial reports and annual financial audit reports.

3. Continuing operations and post-disaster recovery plans should be established for service providers engaged in digital cryptocurrency operations. Drawing on the American regulatory model[4], service providers should formulate corresponding emergency plans in advance, deal with the loss or even bankruptcy of the platform, and submit them to the regulatory authorities, which can determine the feasibility and provide corresponding modification opinions. In light of potential operational and market changes, this process should be updated over time.

   Pass the plan and submit the latest version to the regulatory department. Once the service provider encounters an emergency, it will be dealt with according to the plan, and the regulatory department will assist the service provider in carrying out the necessary measures to protect the interests of the holder.

2 Conclusions

Private digital currencies based on blockchain technology are difficult to serve as legal tender recharges and fulfill the functions of money due to their frequent price fluctuations, lack of value support, and consumption of large amounts of energy. Characteristics of private digital currencies such as decentralization and complete anonymity have made them a major source of money laundering, terrorist financing, and cyber fraud.

In discussions of cryptocurrencies, we found that most people in Chinese society don't know much about them and won't participate in related programs. However, in today's increasingly developing digital economy and crypto technology, the continuous development of the cryptocurrency market is an inevitable trend in the world economy and society, and each of us should have an understanding of cryptocurrencies. China should also adjust its corresponding policies in real time according to the evolving cryptocurrency trend in order to reap the dividends of the development of digital technology. We have found that most of the research within the academic community focuses on studies related to the risks of cryptocurrencies and their control, but there are fewer studies on mainland China's cryptocurrency policies. Our study analyzes the impact of cryptocurrencies on the market by comparing the policies of mainland China and Hong Kong and ultimately explores the best current policy direction for the development of the cryptocurrency market in mainland China. We aim to analyze the state of cryptocurrency market development and related policies in mainland China, and ultimately propose policy recommendations for the future development of the cryptocurrency market in mainland China.

3 Author Contribution

- ***Cheung Arts:*** Our group leader.Current status of cryptocurrencies in China and Hong Kong; collection of news and data.
- ***Sang Tianyi:*** The impact of cryptocurrency market on business, financial market; collection of literature.
- ***Gu Junwei:*** The impact of the cryptocurrency market on business and financial market; slide production.
- ***Ma Jingmei:*** The impact of government policies on the cryptocurrency market in mainland China and Hong Kong.
- ***Jiang Yuxin:*** Suggestions for government policies; slide production
- ***Liu Shengyou:*** Challenges and solutions encountered; contributions and limitations of the project; overleaf

4 Challenges and Solutions

4.1 Challenges

1. **Limited academic resources:**
As a relatively new field, there may be a lack of well-established academic literature on certain aspects of cryptocurrency adoption, impact and regulation. This may pose a challenge to the foundation of existing research.
2. **Technical terminology:**
Cryptocurrencies involve complex technical terminology that may be unfamiliar to non-technical audiences, making it difficult to communicate ideas effectively.
3. **Wide variety of disciplines covered:**
Writing about cryptocurrencies requires knowledge of multiple disciplines. Coherently integrating these different aspects while maintaining accuracy is very difficult.

4.2 Future solutions

1. **Comparative analysis:**
Analyze other cryptocurrency adoption and regulation that may have more mature research areas to compare and draw conclusions.
2. **Analogies and Visual Aids:**
Use analogies to connect complex concepts to familiar ideas. Incorporate visual aids such as diagrams to explain intuitively.

5 Indications and Limitations

5.1 Contributions

1. **Comprehensive analysis:**
   This article provides an in-depth analysis of the cryptocurrency landscape in Mainland China and Hong Kong, revealing cryptocurrency adoption, market trends, and the regulatory environment in these regions. This comprehensive analysis leads to a better understanding of how cryptocurrencies evolve in different regulatory and economic environments.

2. **Market impact:**
   By studying the impact of the cryptocurrency market on companies and financial markets, it is possible to gain insight into how digital assets can disrupt traditional financial systems and business models. The analysis can provide an invaluable resource for policymakers and investors seeking to navigate this emerging landscape.

3. **Policy Insights:**
   Examination of government policies and their impact on cryptocurrencies can provide practical solutions to foster innovation in currencies while managing risks associated with cryptocurrencies.

4. **International Perspective:**
   Comparing the cryptocurrency environment in mainland China and Hong Kong provides a valuable international perspective. It enables readers to assess how different regulatory approaches can grasp developments in the cryptocurrency market and affect cross-border transactions.

5.2 Limitations

1. **Scope limitation:**
   Given the complex and rapidly evolving nature of cryptocurrencies, it is not possible to comprehensively cover all aspects in one paper.

2. **Market uncertainty:**
   The cryptocurrency market is characterized by volatility and uncertainty. Forecasts in the paper may not correspond to actual developments as they unfold.

3. **Cultural and contextual factors:**
   Cultural, economic, and geopolitical factors specific to China and Hong Kong may influence cryptocurrency adoption and regulatory decisions. These factors may require further exploration to fully understand their impact.

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Research Guidelines

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Informed Consent Statement

Not Applicable.

Data Availability

Not Applicable.

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Conflicts of Interest

The authors declare no conflict of interest.

Intellectual Property

The authors attest that copyright belongs to them, the article has not been published elsewhere, and there is no infringement of any intellectual property rights as far as they are aware.

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