

Market Entry: Virtual Currency, Electronic Money and Electronic Payments

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OVERVIEW

China is the world's second largest economy, with an annual growth rate of more than eight percent and a rapidly growing middle class. Foreign investment into China routinely exceeds U.S. \$100 billion a year. Businesses from all over the world must have a China strategy to remain competitive and succeed in the global marketplace.

China is one of the world's largest markets for Internet use. Some reports put the number of Internet users in China at 564 million, almost twice the population of the entire United States, and six times the number of Internet users in America (five times the number in India). In fact, China has as many Internet as than the next four countries combined (US, India, Japan and Germany). The number of mobile web users in China has been estimated at 420 million.

A 2012 McKinsey report stated that 95 percent of those living in Tier 1, 2 and 3 cities are registered on at least one social media site. Over 90 percent of respondents said they had



visited a social media site in the previous six months—the comparable figures are 60 percent in Korea and 67 percent in the U.S. Chinese social-media users are more likely than those in the U.S. to use a social media site as a portal, and to buy products seen or recommended on these sites.

Online payments, virtual currency, electronic currency and electronic payments are key to the full realization of the potential of the Internet. This brief will summarize China's developing regulatory regime covering this new, virtual economy.

USE OF TERMS

In this brief, we will use the term virtual currency to refer to electronic money that can be created by an individual, corporation or organization, or can arise naturally as people use a certain commodity as currency ("Virtual Currency").¹ Virtual currency is distinguished from electronic money produced by government-endorsed central banks and backed by national currency, and that goes through electronic banking and payment systems ("Electronic Money"). Examples of Electronic Money are bank deposits, electronic funds transfers (EFTs), direct deposits, and payment processors. This distinction is important in China in two senses: (a) Virtual Currency is subject to regulation and supervision by the Ministry of Culture, and, in some situations, the Ministry of Commerce, while Electronic Money is regulated by the People's Bank of China; and (b) only Electronic Money can be used for electronic payments.

FOREIGN INVESTMENT IN COMMERCIAL INTERNET OPERATIONS

China restricts foreign investment in commercial Internet operations. In order to conduct any commercial operations over the Internet, an "Internet content provider," or ICP, license is required. These licenses can only be held by a PRC entity with no more than 50 percent foreign ownership. In practice, very few "joint venture ICP licenses" have been granted. This requires foreign investors to use "variable interest entity," or VIE, structures. In a VIE structure, the ICP license is held by a PRC entity controlled by the foreign party, but not owned by it. The legitimacy of this structure has been questioned by some commentators, but it is used by hundreds of companies and has at least the tacit sanction of the Chinese government.

PRC regulation of the Internet is *not* applied extraterritorially. Thus, a business which maintains its servers and stores all of its information outside of China is technically not subject to regulation by the Chinese authorities. However, the PRC's total control over information passing over the Internet in China permits it to restrict or block altogether communications as well as entire domains at will, and it frequently does, even where the operator and all its servers are located outside of China. Companies therefore should be aware of what is, and what is not, considered permissible for companies using the Internet in China.

FOREIGN INVESTMENT IN ONLINE GAMING

Since 2009, foreign investment in online gaming companies in China has been absolutely prohibited, even through the use of contractual, or VIE structures. It is possible for gaming operators to reach Chinese consumers using servers located outside of China but, especially in the gaming sector, lag times and uneven Internet connections make this problematic. Many Chinese consumers are not able to make micro-payments to game operators in hard currency.

VIRTUAL CURRENCY LIMITED TO ONLINE GAMING

In 2007, China completely prohibited the use of Virtual Currency outside the online gaming context.² Within the gaming context, Virtual Currency is defined as a virtual exchange tool expressed in the form of digital units and existing outside of the game program but recorded on the game server, and issued by the online gaming operator, to be directly or indirectly purchased by the online gaming user with legal currency based on a certain exchange rate.³ The regulations provide that Virtual Currency can only be used within the specific game which created it, and the price to redeem it cannot be higher than the original purchase price.⁴ This essentially strips much of the utility from the use of Virtual Currency in China.

As in many other areas, however, practical reality in China differs from legal proscriptions. Given the nature of the Internet, enforcement is difficult, and China may want to provide some limited room for experiment in this novel marketplace. Whatever the reason, the actual use of Virtual Currency in China continues to grow, even outside the gaming context and outside the strict confines of the law.

REGULATION OF VIRTUAL CURRENCY

There are two types of PRC entities that can engage in the Virtual Currency business and stay within the letter of the law: online gaming operators ("Game Operators"), and online gaming virtual currency exchange service providers ("Service Providers"). Game Operators are companies that operate online games and issue/provide Virtual Currency. Service Providers are companies that provide platform services for online game users to exchange Virtual Currency. Under PRC law, a single entity cannot be both a Game Operator and a Service Provider at the same time.

To be a Game Operator or a Service Provider, an entity must have a minimum registered capital of RMB 10,000,000 (about U.S. \$1.6 million in 2013), and to obtain both an Internet Content Provider license from the Ministry of Industry and Information Technology and an Internet Culture Operation Permit from the Ministry of Culture.⁵ Internet Culture Operation Permits are valid for three years, and renewable upon re-application.

The Game Operator must set forth, in its application documents for the Internet Culture Operation Permit, the issuance scope of the Virtual Currency (i.e., to whom the Virtual Currency is to be issued), the unit price of the Virtual Currency, the method of purchasing and redeeming Virtual Currency, and the security measures it will put in place to protect the interests of the users.

The requirements under PRC law for a Game Operator or a Service Provider focus on restricting the circulation of Virtual Currency to the participants in a specific online game, and protecting the economic interests of the users of the Virtual Currency. In addition to repeating that Virtual Currency can only be used for the virtual products or services provided by the Game Operator, PRC law requires detailed information to be archived for at least 180 days, 60-day prior publication notice before any termination of the virtual products or services, and real name registration before purchasing any Virtual Currency.

Any Game Operator or Service Provider that violates the requirements set forth above might be punished by paying penalties ranging from RMB 20,000 to RMB 30,000, or, in severe cases, cancellation of the Internet Culture Operation Permit.⁶

ELECTRONIC MONEY AND ELECTRONIC PAYMENT

Electronic Money is different from Virtual Currency in the sense that Electronic Money is conceptualized money backed by the national currency. Electronic payment is the means for Electronic Money to circulate, and is defined under PRC law as, "a payment activity by which entities or individuals directly authorize others to dispatch payment instruction through digital terminals in order to pay and transfer funds." Electronic Payment ("Electronic Payment")⁷ in China includes online payments, PSTN-based payments, mobile payments, POS transactions, ATM transactions, and other payments conducted through digital means.

According to the *Rules on Administration of Non-Financial Institutions Providing Payment Services*⁸ ("Administrative Rules on Payment Services"), all non-financial institutions ("Payment Institutions") that intend to engage in Third Party Electronic Payment Services⁹ must apply for Payment Business Permits with the People's Bank of China. There are several principal requirements for these Permits:

- The minimum registered capital for a Payment Institution providing nationwide Third Party Electronic Payment Services is RMB 100 million; for provincial-wide services, RMB 30 million.
- The major investor of such a Payment Institution shall have been providing information processing and supporting services to financial institutions or e-commerce business entities for more than two consecutive years, and have been making profits for at least two consecutive years.
- The Payment Institution must satisfy anti-money laundering measures, and have equipment sufficient to support the proposed payment services.

A Payment Business Permit is valid for five years, and can be renewed upon reapplication. Many other requirements for Payment Business Permit holders are included in the Administrative Rules, which should be consulted in each case.

There are no specific regulations dealing with foreign investment in this industry, although the Administrative Rules on Payment Services provide generally that the business scope, qualification requirements for foreign investors, and the maximum capital contribution ratio for a foreign invested Payment Institution are set by the People's Bank of China. As of mid-2013, two wholly-foreign-owned enterprises (Edenred China and Sodexo Pass China), along with a total of 248 other Chinese companies, have obtained Payment Business Permits.

Finally, the Ministry of Commerce and the State Administration of Industry and Commerce have published several rules regulating online commodity transactions and relevant services. The regulations focus principally on operating requirements for online payment platform providers, including requiring online payment platform providers to be equipped with the ability to provide payment settlement services for e-commerce transactions via banking institutions or non-financial business entities approved by the relevant State departments, and to ensure the safety and effectiveness of online payments.

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ENDNOTES

1. In China, the most popular virtual currency includes Q-Coin issued by Tencent, U-Coin issued by Sina, and POPO Coin issued by Netease. There is also a small but growing use of Bitcoin in China.
2. *Notification on Further Strengthening the Administration of Internet Café and Online Gaming*, promulgated by Ministry of Culture, State Administration of Industry and Commerce, Ministry of Public Security, and Ministry of Information Industry on February 15, 2007.
3. *Notification on Strengthening Administration of Virtual Currency in Online Gaming*, published by the Ministry of Culture and the Ministry of Commerce on June 4, 2009.
4. *Ibid.*
5. *Tentative Rules on Online Gaming Administration*, promulgated by the Ministry of Culture on June 3, 2010.
6. *Ibid.*
7. *Directive on Digital Payment*, published by People's Bank of China on October 26, 2005.
8. *Rules on Administration of Non-Financial Institutions Providing Payment Services*, promulgated by the People's Bank of China on September 1, 2010.
9. Third Party Electronic Payment Services are defined as services provided by non-financial institutions to transfer funds between payer and payee, which include online payment, pre-paid card, card acquiring services, and other payment services as determined by the People's Bank of China from time to time.



This outline does not constitute legal advice. The legal consequences of any given transaction or situation must be examined on its individual facts. You should consult counsel before engaging in any transaction of a type contemplated in this outline.

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