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NEW REGULATIONS ISSUED TO STRENGTHEN ADMINISTRATION OF VIRTUAL CURRENCIES

Introduction

The buying and selling of make-believe currencies used in online gaming (**Virtual Currency**) has been one of hottest topics in the online gaming space in China. Although Virtual Currency has helped drive the online game industry's success in China by facilitating electronic payments, regulators have long been concerned about its potential for misuse in illegal activities such as gambling, money laundering, piracy and online theft. The authorities have also expressed concern that recent explosive growth in Virtual Currency markets may have a negative impact on real financial markets or contribute to inflationary pressures. As a result, on June 26th the Ministry of Culture (**MOC**) and the Ministry of Commerce jointly issued the *Notice on the Strengthening of Administration on Online Game Virtual Currency* (**Notice**). The Notice tightens regulatory control over Virtual Currencies and is likely to have a significant impact on the online game industry and game operation models.

Key Provisions of the Notice

1. Definition of Virtual Currency

Virtual Currency is broadly defined in the Notice as follows:

A type of virtual exchange instrument issued by Internet game operation enterprises, purchased directly or indirectly by the game user by exchanging legal currency at a certain exchange rate, saved outside the game programs, stored in servers provided by the Internet game operation enterprises in electronic record format and represented by specific numeric units. Virtual currency is used to exchange Internet game services provided by the issuing enterprise for a designated extent and time, and is represented by several forms, such as prepaid game cards, prepaid amounts or Internet game points, and does not include game props obtained from playing online games.

Notably, game props (i.e. virtual items or equipment used in a particular game), are explicitly excluded from the above definition. The Notice specifically states that game props should not be confused with Virtual Currency and that the MOC, jointly with other authorities, will issue separate rules to govern them.

2. Requirements on Issuers and Trading Platforms

The Notice categorizes companies involved with Virtual Currency as either issuers (**Issuers**) or trading service providers (**Trading Platforms**). Both types of company must now obtain an Online Culture Permit from the MOC whereas previously Trading Platforms were recognized as providing ancillary services to online games, and therefore not subject to such permit requirement.

The definition of Issuers clearly includes game operating entities, however the definition of Trading Providers is not as clear. This group would likely not only include dedicated trading platform providers and auction sites, but also e-commerce platforms that allow trading of Virtual Currency. The Notice prohibits companies from simultaneously engaging in both Issuer and Trading Platform activities.

Existing Issuers and Trading Platforms should apply for an Online Culture Permit within three months after the date the Notice was published.

3. Reporting of Virtual Currency Characteristics

In applying for an Online Culture Permit, an Issuer is now required to submit certain detailed characteristics of its Virtual Currency to the MOC, including the form of the currency, the extent of its circulation, its unit purchase price, and how the virtual currency is refunded upon termination of services. Trading Platforms must provide the MOC with details of their service models and the correlation between user accounts and corresponding real-name bank accounts. Issuers are prohibited from altering the unit purchase price of the Virtual Currency and are required to file with the applicable cultural administrative department prior to issuing new types of Virtual Currency.

4. Control and Limitation on Amounts and Usage

One of the Notice's intended objectives is to limit the circulation of Virtual Currency and thereby reduce concerns that it may impact real world inflation. To address this objective, the Notice provides that:

- Game operating entities are required to issue Virtual Currency in an appropriate manner commensurate with their operational needs, and are explicitly prohibited from issuing disproportionate amounts of Virtual Currency in order to generate revenues.
- Issuers are also required to report their total issued Virtual Currency amounts on a quarterly basis to the provincial cultural department where Issuers are located. By imposing this requirement, the amount of issued Virtual Currency managed by Issuers is likely to be closely monitored and tightly controlled.
- Virtual Currency can only be provided to users in exchange for a RMB payment.

- Virtual Currency can only be used to pay for virtual goods and services of the Issuers; it may not be used to purchase any tangible products, or pay for third-party products or services.

5. Other Provisions

- To address rampant fraudulent trading in Virtual Currency, Trading Platforms must require their users to register under their real names, and must link their accounts with verifiable real-world bank accounts.
- Trading Platforms are required to keep transaction data records for no less than 180 days and are prohibited from providing Virtual Currency trading services to minors.
- The Notice urges strict action against illegal gambling using Virtual Currency, as well as online games that have gambling features. It also prohibits game operators from allocating game props or Virtual Currency randomly through lucky draws or lotteries conducted on the condition that participating users contribute cash or Virtual Currency.

Commentary

The Notice demonstrates the government's intention to closely monitor the status of Virtual Currency in the market, and particularly the MOC's intent to expand its regulatory reach in the online gaming industry.

The prohibition on a company concurrently serving as an Issuer and Trading Platform is likely to impact the business model of some game operators who do use Virtual Currency in their games (as an Issuer) and also enable users to openly trade Virtual Currency, or make it technically possible to do so. It is unclear whether these Issuers will also be viewed as undertaking Trading Platform activities and if so, whether they will be required to change or restructure their operating models to comply with the prohibition on simultaneous issuing and trading.

Finally, government monitoring on the amount of Virtual Currency in circulation and limitations on the legal uses of such currency will likely reduce the liquidity of some of the more popular types of Virtual Currency. Certain activities, such as purchasing power beyond that of the Virtual Currency's designated online game or bundling Virtual Currency with services and products of other parties, are likely to be significantly curtailed or disappear altogether.

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