



## **Chinese Central Bank's Bitcoin Regulatory Situation**

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### **1. Introduction**

Unlike the legal currency, the cryptocurrency refers that does not have guarantee of value by a specific authority in the expression of digital value. At present, about 650 kinds of cryptocurrencies are issued, and the total market capitalization of the total reaches near USD20 billion<sup>1</sup>. Especially, bitcoin accounts for about 85% of the total, and the number of transactions is increasing day by day as a new means of settlement.

On the other hand, due to the size of price volatility, there are aspects that bitcoin has been traded as a speculation merchandise. In particular, there was a time that transactions denominated in RMB occupying more than 90% of the total transaction because of the domestic economic and currency circumstances.

Under these conditions, Chinese authorities have started imposing various numbers of regulations in 2017 and are still continuing measures to limit excessive transactions.

In this article, I would like to review the history of various regulations concerning bitcoin in the past, and consider the change of the volumes of bitcoin transactions accompanying it.

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<sup>1</sup> Please refer to <http://coinmarketcap.com>

## 2. Recent Regulatory Trends

Since January 2017, the Chinese central bank (PBoC) jointly inspected China's main bitcoin trading platforms with relevant departments of the Chinese government to take a series of regulatory measures. The inspection level is much higher than the general internet financial risk investigation, showing the degree of attention of the central bank to the supervision of the bitcoin.

Date	Event (Both PBoC and Bitcoin Platforms)
① 2017.1.6	PBoC met with the management of three largest bitcoin platforms (Bitcoin China (BTCC), Huobi, and OK Coin) in Beijing and Shanghai, suggesting that there may be legal risks, policy risks, and technical risks. Requiring its management must carry out self-examination in compliance with the law and regulations
② 2017.1.11	PBoC announced it established joint inspection teams in Beijing and Shanghai, stationed in major bitcoin trading platforms to carry out the on-site inspection.
③ 2017.1.18	PBoC announced that the joint inspection teams discovered that some bitcoin trading platforms carried out illegal financing business, relating to abnormal market volatility.  The inspection team also found some problems, such as the lack of sound anti-money laundering internal control system, and the investor's funds were not subject to supervision.
④ 2017.1.25	BTCC, Huobi, and OK Coin announced that they will collect 0.2% transaction fees for each deal, and will stop leveraged financing.  PBoC announced that the investigation of the bitcoin trading platforms will continue. The next step will focus on payment and settlement, anti-money laundering, foreign exchange management, financial security and other aspects.
⑤ 2017.2.8	The inspection teams engaged in other smaller 9 platforms in Beijing put forward specific requirements. The announcement said that the platforms shall not offer leveraged financing service, shall not violate the laws and regulations on anti-money laundering, foreign exchange administration, payment and settlement, taxation and so on.

	If there is a bitcoin trading platform in violation of the above requirements, the inspection team may ask relevant departments to close down the platform.
⑥ 2017.2.9	Huobi and OK Coin announced that they will stop withdrawal of the bitcoin as there was an imperfection in provision for anti-money laundering, as a response to the inspection of February 8 <sup>th</sup> .  They also announced that in order to reconstruct the structure, the stop of the withdrawal will maintain 1 month at longest.

(Source: <http://www.pbc.gov.cn/> and others)

### 3. Regulatory Background

#### (1) Regulatory Motives

The main motives of this time's regulations are:

- Bitcoin price soared by the end of 2016, the highest point was close to RMB9, 000- per bitcoin. Because of high leverage and speculative investment, there are huge risks of this bubble. Bitcoin changed from a small speculative virtual currency into a hot investment boom in China. If the high price attracts more and more ordinary people to follow this speculative boom, may cause the same results like the P2P<sup>2</sup> resulting in a large number of ordinary people lose money and lead to social problems.
- In the context of the devaluation of the RMB, some media reported that some people exchanged RMB to bitcoin, and then sold in US dollars to bypass the strict regulation of foreign exchange.
- Cases involving money-laundering, illegal fund-raising and other illegal activities happened.

#### (2) The Origin of Regulation

China's first bitcoin regulation occurred in October 2013. The boss of GBL, which was a Chinese bitcoin trading platform which ranked world's 5th biggest in market size, tried to abscond with money, resulted in the losses of more than RMB30 million and GBL was also accused. This outbreak of China's first bitcoin platform fraud is considered to directly promote the introduction of regulatory policy by the Chinese government.

On December 5th, 2013, PBoC and other five ministries issued a notice: "**Prevention of Risks**

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<sup>2</sup> Service that mediates the lending and borrowing of money between individuals by using the internet. The Chinese authority announced the enforcement of the regulations on August 2016.

**Associated with Bitcoin**”, made PBoC became the world's first central bank which announced regulatory policies on the bitcoin and its trading platforms.

The points of this notice were:

- In this notice, PBoC clarified the nature of the bitcoin, which the bitcoin is not issued by the monetary authorities, does not have the same legal status of money, cannot and should not be used as currency in the market circulation.
- This document also requires financial institutions and payment institutions not to directly or indirectly provide customers with services related to bitcoin. The notice also said that bitcoin is a specific virtual good, because of its small market capacity, anonymous and geographical restrictions, there may be a high speculation or money laundering risk, and may be used by criminals.
- But it didn't close the door. It said that the bitcoin transactions, as acts of buying and selling goods on the internet, people have the freedom of participation at their own risk.

After the introduction of this document, bitcoin platforms have indeed received the notification of stopping services from the banks, and bitcoin-related business settlement services were stopped. However, the platforms used prepaid code to bypass the provisions, that is, the users transfer money to a third party company, to get a code, then use the code to charge the account to bypass the regulation.

But even this policy has not been strictly enforced for a long time, after several months, the bank channels of the platforms is gradually restored.

### **(3) The Bubbles of Bitcoin Market**

After several years of development, China became the world's most important player of bitcoin. In 2016, China's bitcoin trading volume accounted for more than 90% of global transaction volume, and the volume of China's three largest bitcoin trading platforms accounted for 80% of the global bitcoin market's volume for a long time.

However, it is noteworthy that there were bubbles in China's bitcoin market beyond its surface of huge trading volume and high price.

- In the aspect of **volume**. Because of intense competition, China's trading platforms didn't charge transaction fee. So, some investors use the computer programs for high-frequency automatic quantitative trading to earn the price gaps between the different platforms. The platforms also create “fake transactions” to increase the volume. It means that the trading platform only needs to set an account to accept deals from only a specific block-chain address, the address is another set account. This kind of left-hand to a right-hand transaction only increases the volume but has no true bitcoin transfer. The trading platforms believed that larger volume could attract investors. Because the bitcoin is still

in a gray area and lacks supervision, it's difficult for normal investors to find out fake transactions.

- In the aspect of **price**. One of the key reasons for the price spike in 2016 is leveraged trading. Because there is no transaction fee, beside the withdrawal charge that happens when users withdraw bitcoins into RMB, the platform's main profit is the leveraged financing fees, the annualized interest rates may as maximum 40%. The platforms typically offer leverage up to five times and the platforms encouraged users to use high leverage, which made the bitcoin price increased speculatively.

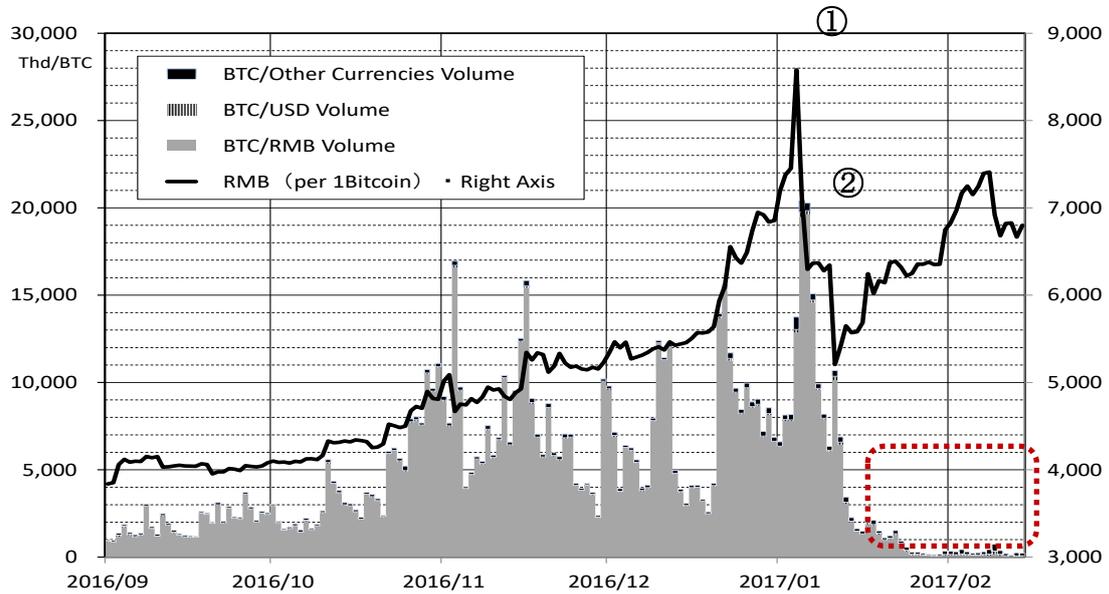
#### **4. The Regulatory Effect and Future Forecasts**

On January 25th, the three biggest platforms all announced that 0.2% transaction fees for each deal, and stopped leveraged financing. Also on February 9th, part of the platforms announced that the bitcoins in the account cannot be converted into RMB anymore within one month.

The high transaction fees made the high-frequency quantitative transaction and false transactions difficult to continue. Leveraged financing and derivative services have also been completely halted, which made the current Chinese bitcoin market has become a relatively simple non-leveraged market. The latest ban on conversion further hit the market.

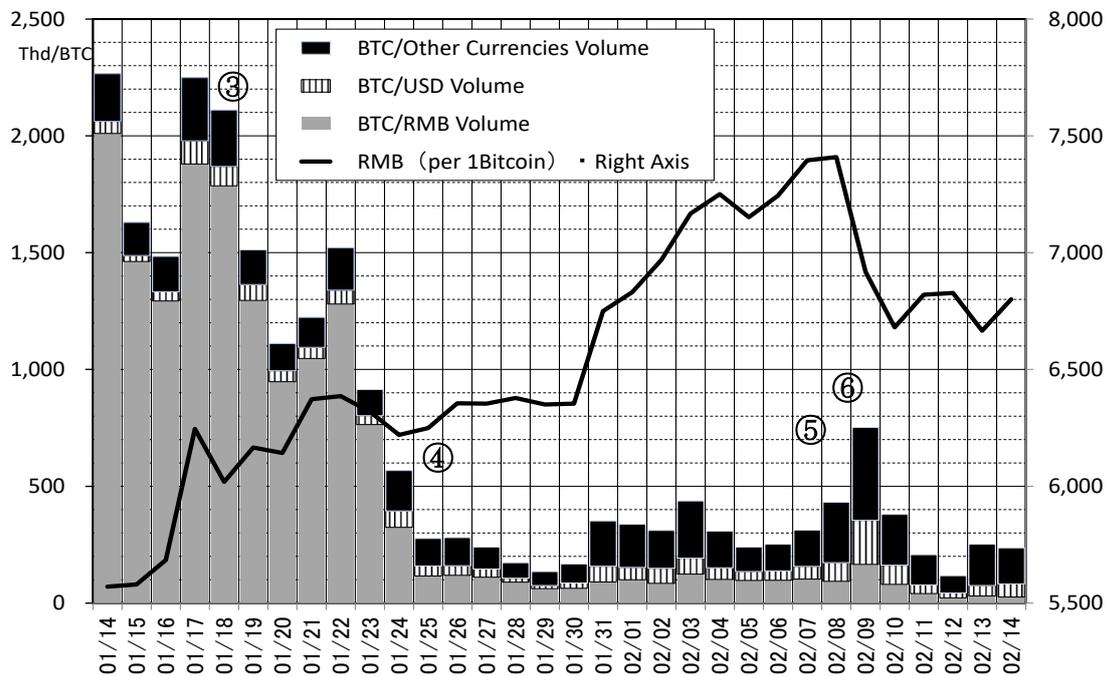
These measures directly led to a significant reduction in trading volume, the price reduced significantly right after the regulatory movements but raised back again because of the influence of the international market. But, compares to its peak hit on the beginning of January, the volume is extremely low right now, which it means apparent that the market overheated mood has become calm. And it indicates that the boom in China had become over.

**Graph 1.1 : Process of the Transaction Volume of Each Currency**



(Refer to Figure1.2)

**Graph 1.2 : Process (From January 14th, 2017)**



(Graph made by IIMA by the source of <https://www.coinhills.com> and others)  
 (Numbers are linked to the event which is described at page2)

As PBoC announced that the investigation of the bitcoin trading platform will still continue, there may have more information to appear in the future.

At present, the only relevant policy is the notice issued in 2013, may not be able to adapt to the latest situation anymore. There is a possibility that PBoC will further issue a new policy for the entire bitcoin market.

This may mean that as the portion of the exceed speculation transaction decrease in China, it will develop a price formation system for transactions based on the global demand and supply, and make the bitcoin circulate in a genuine manner in the future.

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