

HKCGI Technology Guidance Note (Twelfth Issue) – Hong Kong SFC’s newly implemented licensing regime for virtual asset trading platforms (Part 1)

Introduction

The 'Policy Statement on Development of Virtual Assets in Hong Kong', published by the Financial Services and Treasury Bureau in October 2022, outlined the government's strategy for creating a thriving industry and ecosystem for virtual assets (VA).

The Policy Statement notes that Hong Kong, as an international financial centre, is open and inclusive towards the global community of innovators engaging in VA businesses. The government acknowledges the potential for distributed ledger technology and Web 3.0 to improve efficiency and transparency in business and finance, and believes that Hong Kong shows signs of a vibrant VA ecosystem. The government is dedicated to fostering an environment that will

support a responsible and sustainable growth of the VA industry. The governance expert must stay current with technological advancements.

By implementing favourable policies, thorough and balanced regulations, risk-based guardrails, and pilot projects, the government intends to promote the sustainable development of financial services along the full VA value chain, covering aspects such as the issuance of VA, tokenisation, trading and settlement platforms, financing and asset management, and custody. It extends an invitation to the international VA community to work together in leveraging Hong Kong's position as a major international financial centre, to support financial innovation under a "clear, agile and facilitating regulatory environment" that adheres to international standards and best practices.

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A centrepiece in this regulatory environment is the Securities and Futures Commission (SFC)'s new licensing regime for VA trading platforms (VATPs) under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (AMLO), which came into effect on 1 June 2023. The regime aligns investor protection, anti-money laundering and counter-terrorist financing requirements for VATPs with those in place for conventional financial institutions, thereby offering licensed VATPs the status and credibility to access a larger pool of investors.

This guidance note (in two parts) aims to improve the technical expertise of governance professionals to capture potential prospects from cyber advances that call for their governance advisory and support services.

Meaning of virtual assets

The governance professional must understand the wide definition of VAs. Section 53ZRA of the AMLO defines a VA as a cryptographically secured digital representation of value that:

- is expressed as a unit of account or a store of economic value, and can be transferred, stored or traded electronically; and
- either:
 - o is used (or is intended to be used) as a medium of exchange accepted by the public, for any one or more of the following purposes – (a) payment for goods or services, (b) discharge of a debt, or (c) investment; or
 - o provides rights, eligibility or access to vote on the management, administration or governance of the affairs in connection with, or to vote on any change of the terms of any arrangement applicable to, any cryptographically secured digital representation of value; and

- satisfies other characteristics prescribed by the SFC by notice published in the Gazette;

Or alternatively:

- is a digital representation of value prescribed as a VA by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

The following are not considered as VA under the AMLO:

- digital representations of fiat currencies (including digital currencies issued by central banks);
- limited purpose digital tokens such as air miles, credit card rewards, gift cards, customer loyalty programmes and gaming coins;
- securities and futures contracts regulated under the Securities and Futures Ordinance (Cap. 571) (SFO);
- floats or stored value facility deposits regulated under the Payment Systems and Stored Value Facilities Ordinance (Cap. 584).

Dual licensing regime

The SFC regulates the trading of security tokens by VATPs under the existing SFO licensing regime, and the trading of non-security tokens by VATPs under the newly implemented AMLO regime which took effect on 1 June 2023.

Given that the terms and features of a VA may evolve over time, a VA's classification may change over time from a security token to a non-security token, or vice versa. The SFC has cautioned that, to avoid contravention of the licensing regimes and to ensure business continuity, it would be prudent for VATPs (together with their proposed responsible officers and licensed representatives) to apply for approval under

both the SFO and the AMLO regimes and be dual-licensed. The SFC has indicated that it will adopt a streamlined application process so that only a single consolidated application needs to be submitted for a dual-licence application.

The SFC has also clarified that one individual may be concurrently approved under both the SFO and the AMLO regimes so that dual-licensed VATPs are not required to maintain four different responsible officers. The SFC appreciates that there may be a lack of talent with both VA and traditional securities experience and have indicated that they will adopt a pragmatic approach in this regard.

VATP applicants are required to engage an external assessor to assess their proposed structure, governance, operations, systems and controls and submit reports to the SFC when (i) submitting their licence application (phase 1 report) as well as (ii) after approval-in-principle is granted by the SFC (phase 2 report). The SFC will grant final approval only if it is satisfied with the findings of the phase 2 report.

Separately, the SFC has confirmed that the AMLO regime covers VATPs that are centralised and operate in a manner similar to traditional automated trading venues licenced under the SFO. Therefore, the AMLO regime does not apply to the provision of VA services without an automated trading engine and ancillary custody services, such as over-the-counter VA trading activities and VA brokerage activities.

The SFC is aware of the importance of VA derivatives to institutional investors and will conduct a separate review in due course. As for stablecoins, prior to them being subject to regulation in Hong Kong (arrangements are expected to be implemented by the Hong Kong Monetary Authority in 2023/24), they will not be admitted for retail trading.

Transitional arrangements

The SFC has provided transitional arrangements in relation to the newly implemented licensing regime

under the AMLO (ie, in relation to VATPs providing trading services in non-security tokens). There are no transitional arrangements for compliance with the existing licensing regime under the SFO. VATPs that intend to provide trading services in security tokens should therefore commence such business only upon obtaining the relevant SFO licence.

The transitional arrangements for the AMLO licensing regime only apply to pre-existing VATPs, ie, VATPs that were providing a VA service with meaningful and substantial presence (ie, carrying on a genuine business with genuine presence) in Hong Kong before 1 June 2023. The arrangements comprise:

- *A non-contravention period from 1 June 2023 to 31 May 2024* – Pre-existing VATPs may continue to provide their VA service in Hong Kong during this 12-month period without being in breach of the licensing requirements under the AMLO. This also applies to individuals performing a regulated function in Hong Kong for pre-existing VATPs.
- *A deeming arrangement from 1 June 2024* – Qualified pre-existing VATPs (and their proposed licensed individuals) will be deemed to be licensed until their licence applications are withdrawn, refused or approved, if they meet specified conditions. These include (among others) submitting a completed online licence application to the SFC by 29 February 2024, confirming that they will comply with the regulatory requirements applicable to a licensed VATP on being deemed, and proving to the SFC that they have a reasonable prospect of successfully showing that they are capable of such compliance. Once deemed to be licensed, the VATPs and their proposed licensed individuals will be subject to the SFC’s supervisory, disciplinary, intervention and other applicable powers under the AMLO.

VATPs that are not pre-existing VATPs are not eligible for the transitional arrangements. They should not

commence any VATP business activities in Hong Kong, or actively market any VA service to Hong Kong investors, until they are licensed by the SFC.

Pre-existing VATPs that do not intend to apply for a licence should proceed to an orderly closure. The strict deadline to close down is 31 May 2024. However, the SFC expects them to cease any active marketing of their services to Hong Kong investors and commence the closing down of their operations in Hong Kong.

Further details are set out in the SFC’s ‘Circular on transitional arrangements of the new licensing regime for virtual asset trading platforms’ dated 31 May 2023, which is available on the SFC’s [dedicated webpage for VATP operators](#).

The SFC has published several lists of VATPs on its website as part of its efforts to disseminate information on VATPs in a clear, transparent and timely manner. These [lists](#) include:

1. “List of licensed virtual asset trading platforms” (List of licensed VATPs), which sets out the names of VATP operators formally licensed by the SFC;
2. “List of virtual asset trading platform applicants” (List of VATP applicants), which sets out the names of VATP operator applicants (VATP applicants) whose licence applications have yet to be approved by the SFC; this list is accompanied by a “List of applicants whose licence applications have been returned, refused or withdrawn” (List of removed VATP applicants), which sets out the names removed from the List of VATP applicants as their licence applications have been returned, refused or withdrawn;
3. “List of closing-down virtual asset trading platforms” (List of closing-down VATPs), which sets out the names of VATP operators required by law to close down within a specified period; and

4. “List of virtual asset trading platforms which are deemed to be licensed” (List of deemed licensed VATPs), which sets out the names of VATP operators deemed to be licensed as of 1 June 2024.

The SFC has also issued a [dedicated list of suspicious VATPs](#) on its website to help investors more easily identify suspicious VATPs doing business in Hong Kong and enhance awareness.

New and revised guidance

The SFC has issued new guidance on the AMLO VATP regime as well as revised its existing guidance in light of the new regime. They include:

- (New) *Guidelines for Virtual Asset Trading Platform Operators* – Cover both licensing and conduct requirements and are based on the existing regulatory requirements under the SFO licensing regime;
- (Revised) *Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers)*;
- (Revised) *Prevention of Money Laundering and Terrorist Financing Guideline issued by the Securities and Futures Commission for Associated Entities of Licensed Corporations and SFC-licensed Virtual Asset Service Providers*;
- (New) *Disciplinary Fining Guidelines (for regulated persons under Part 5B of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance)* – Set out considerations relevant to the level of a disciplinary fine;
- (New) *Licensing Handbook for Virtual Asset Trading Platform Operators*;

- (New) *FAQs on licensing matters and conduct-related matters;*
- (New) *Circular on transitional arrangements of the new licensing regime for virtual asset trading platforms dated 31 May 2023 (as mentioned above);*
- (New) *Circular on implementation of new licensing regime for virtual asset trading platforms dated 31 May 2023.*

The above can all be accessed on the SFC's [dedicated webpage for VATP operators](#). The governance professional desiring to fully understand the new regime should review such guidance.

Please see Part 2 of this guidance note regarding the features of the new regime, including key regulatory requirements and new fraud-related criminal offences involving VAs.