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New Era Dawns for Hong Kong's Virtual Assets Sector

The regulatory perimeter continues to expand as the Securities and Futures Commission introduces a comprehensive regime to regulate virtual asset service providers.

Key Points:

- The Hong Kong government passed legislative amendments to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO), which will create a framework for regulating virtual asset service providers (VASPs) in Hong Kong.
- The regime, which will come into effect on 1 June 2023, will initially bring centralised virtual asset trading platforms within the regulatory perimeter of the Securities and Futures Commission (SFC). Any person operating a virtual asset trading platform in Hong Kong or actively marketing such services to the Hong Kong public will require a licence from the SFC.
- The SFC has published its consultation conclusions setting out the comprehensive regulatory framework which will govern virtual asset trading platforms. Particularly important is that the retail public will be allowed access to crypto trading, albeit with certain limitations. Areas covered by the regulations include: token admission, investor protection, custody, trading, corporate governance, insurance and compensation, and anti-money laundering and combatting the financing of terrorism (AML/CFT).
- Platforms will need to carefully consider whether they want to comply with the requirements, or else ensure they do not trigger the licensing obligation. However, successfully obtaining a licence from the SFC and being subject to its ongoing supervision may provide clients with much-needed reassurance that the platform has implemented proper governance and controls, especially pertinent in light of recent market developments.
- As the regulatory perimeter continues to expand, now is the right time for crypto firms and intermediaries to assess their virtual asset activities in Hong Kong.

This Client Alert reviews key obligations and requirements which the new regime will impose on virtual asset trading platforms (VATPs). The Client Alert also discusses next steps for those considering to apply for a licence and assesses the current virtual asset legal and regulatory framework in Hong Kong.

Introduction

In December 2022, Hong Kong passed and gazetted the final Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 (Amendment Bill), which will establish a new licensing regime and statutory framework for VASPs from 1 June 2023. Initially, the Amendment Bill will apply to anyone

operating a centralised virtual asset exchange in Hong Kong (or actively marketing such services to the Hong Kong public).

On 20 February 2023, the SFC published a [Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators Licensed by the Securities and Futures Commission](#) (Consultation Paper) to consult the market on its proposed regulatory framework for VASPs. The Consultation Paper followed the soft consultation which the SFC conducted in October and November 2022 with key stakeholders and industry participants.

On 23 May 2023, the SFC published its [Consultation Conclusions](#) to the Consultation Paper (Consultation Conclusions). Over 150 responses were received from a variety of stakeholders and interested parties, including intended VASP applicants, crypto native firms, and industry bodies.

The finalized rules set out a comprehensive framework covering, among others, trading, custody, AML/CFT, corporate governance, and internal controls that VASPs must implement. It reflects the SFC's proposed balance between investor protection and market development, following continued fallout from the collapse of well-known crypto firms globally and the Hong Kong government's policy stance to support the development of virtual assets (VAs).

Some of the regulatory obligations maintain requirements which the SFC [has already imposed on existing SFC-licensed VA trading platforms](#) under its opt-in policy based on the current securities regime. Other changes relax certain requirements, most notably allowing platforms to deal with retail clients. When the VASP regime comes into effect, the SFC intends to govern both regimes under the same set of rules. For the purposes of this Client Alert, the term VATP refers to both trading platforms licensed under the VASP regime and exchanges regulated under the securities regime.

VATPs will be principally governed by the following regulations:

1. *Guidelines for Virtual Asset Trading Platform Operators* (VATP Guidelines), which sets out the regulatory framework which VATPs will be required to comply with;
2. *Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers) and 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* (together, the AML/CFT Guidelines), which sets out the AML/CFT obligations which SFC-licensed entities (including VATPs) will be required to comply with; and
3. *Disciplinary Fining Guidelines* (Disciplinary Guidelines), describing how the SFC will exercise its disciplinary powers in case of breach of the relevant laws by VATPs or their regulated persons.

The trading of security tokens will continue to be principally governed by the Securities and Futures Ordinance (SFO), so VASPs licensed under AMLO will also need to obtain an SFO licence to facilitate trading in security tokens. The SFC has noted that, because the terms and features of a VA can evolve over time (e.g., a non-security token can change to a security token, or vice versa), "it would be prudent" for VASPs to be dually licensed and approved under both the AMLO and SFO regime (and existing SFC-licensed platforms under the SFO regime should also obtain a VASP licence). In that case, the VATP would also be governed by the SFO, its subsidiary legislation and the regulations established under the SFO (including the Code of Conduct for Persons Licensed by or Registered with the Securities and

Futures Commission). The SFC intends for the two regimes to be functionally equivalent and will streamline licensing and supervision under both regimes.

The Regulatory Regime for VATPs

The VATP Guidelines set out a robust framework for VATPs governing a wide range of issues. The table below summarises some key aspects of the regulatory regime. Many obligations will be familiar to those well-versed in the current securities and futures regime.

The SFC will impose these obligations by requiring VATPs to comply with the VATP Guidelines and the AML/CFT Guidelines. These obligations apply in addition to those statutory requirements established in the AMLO and/or the SFO.

Key Obligation	Description
<p>Conduct of Business Principles</p> <p>(paragraph 5.1 of the VATP Guidelines)</p>	<ul style="list-style-type: none"> • Fundamentally, the SFC expects that VATPs (and their representatives) will act with high ethical standards. In this regard, VATPs will be subject to compliance with overarching principles, which include: <ul style="list-style-type: none"> – acting honestly, fairly, and in the best interests of their clients and the integrity of the market; – acting with due skill, care, and diligence, in the best interests of their clients and the integrity of the market; – having and employing effectively the resources and procedures required for the proper performance of their business activities; – seeking from their clients information about their financial situation, investment experience, and investment objectives and assess their risk tolerance level and risk profile relevant to the services to be provided; and – ensuring that client assets are promptly and properly accounted for and adequately safeguarded. • These principles are drafted broadly, and VATPs will be required to comply with the spirit of the requirements. VATPs will therefore need to ensure that their culture, conduct, and behaviour aligns with high ethical and legal standards. • Breach of these principles can result in disciplinary action. The SFC has traditionally used similar general principles in codes of conduct to sanction unethical behaviour by intermediaries.
<p>Token Admission, Due Diligence, and Monitoring</p> <p>(paragraphs 7.1 – 7.14 of the VATP Guidelines)</p>	<ul style="list-style-type: none"> • VATPs will be required to set up a token admission and review committee to establish and implement the criteria for a VA to be admitted to or withdrawn from trading on the exchange. • VATPs will need to conduct due diligence to ensure that tokens are appropriate for listing on the platform. Relevant factors include the background of the management or development team of the token; its regulatory status; the supply, demand, maturity, and liquidity of the token; and the risks associated with the token. • For smart-contract-based VAs, VATPs should exercise due skill, care, and diligence in selecting and appointing an independent assessor to conduct a smart contract audit,

Key Obligation	Description
	<p>unless it would be reasonable to rely on a smart contract audit conducted by an independent assessor engaged by a third party.</p> <ul style="list-style-type: none"> VATPs should continuously monitor each VA and decide whether to suspend or withdraw a VA from trading if the VA is no longer appropriate to be listed. <p><i>Security tokens</i></p> <ul style="list-style-type: none"> As noted above, VATPs that wish to trade security tokens will be required to be licensed under the securities regime. For SFC-licensed trading platforms, the SFC currently requires security tokens to be (i) asset-backed, (ii) approved or qualified by, or registered with regulators in comparable jurisdictions, and (iii) with a post-issuance track record of 12 months. However, in light of the changes in the market landscape — particularly around the development of tokenised securities — the SFC will no longer require security tokens to meet all of these additional requirements. This relaxation is particularly relevant as Hong Kong intends to lead in the development of tokenising securities (and the Hong Kong government recently announced the launch of a tokenised green bond). <p>Instead, the SFC intends to issue further guidance in due course on how security tokens can be distributed.</p>
<p>Retail Access (paragraphs 7.7 – 7.8 and 7.10 – 7.12 of the VATP Guidelines)</p>	<ul style="list-style-type: none"> Currently, SFC-licensed exchanges are only permitted to deal with “professional investors”, meaning high-net-worth individuals with a portfolio of at least HK\$8 million (around US\$1 million), corporations with portfolios of at least HK\$8 million or total assets of at least HK\$40 million (around US\$5.16 million), or institutional investors such as licensed banks, broker-dealers, and asset managers. <p>This restriction will be relaxed to allow VATPs to onboard retail clients, but they will be required to limit access to only “eligible large-cap virtual assets”.</p> <ul style="list-style-type: none"> The SFC expects that the VAs made available to retail clients will meet the VATP’s own token admission criteria, not be “securities” under the SFO, and have high liquidity. In particular, the VAs will be required to feature in at least <u>two “acceptable indices”</u> issued by at least <u>two separate and independent (from each other, the issuer of the VA, and the VATP) index providers</u>. An “acceptable index” uses a clearly defined objective to measure the performance of the largest VAs in the global market and fulfils the following criteria: <ul style="list-style-type: none"> The index should be investible, meaning the constituent VAs should be sufficiently liquid. The index should be objectively calculated and rules-based. The index provider should possess the necessary expertise and technical resources to construct, maintain, and review the methodology and rules of the index. The methodology and rules of the index should be well documented, consistent, and transparent. <p>At least one of the indices used should be issued by an index provider which has experience in publishing indices for the traditional non-VA financial market (e.g., the</p>

Key Obligation	Description
	<p>provider also issues an index tracked by an SFC-authorized index fund) and complies with the IOSCO Principles for Financial Benchmarks.</p> <ul style="list-style-type: none"> • If an eligible large-cap token is removed from the index or is no longer eligible (e.g., because of material adverse news or liquidity issues), then the platform will need to consider how to handle trading and retail clients holding existing positions. • A written legal opinion on the regulatory status of the VA does not need to be provided to the SFC, but the SFC may request this at their discretion. • If a token meets all the other token admission criteria (except for those mentioned in this section) and a VATP wishes to make the token available for retail access, it can submit a detailed proposal for the SFC to consider on a case-by-case basis. • The Hong Kong Monetary Authority is currently in the process of designing a stablecoin regime for Hong Kong. <u>Prior to stablecoins being subject to regulation in Hong Kong, the SFC's view is that stablecoins should not be admitted for retail trading (although this does not expressly appear in the VATP Guidelines).</u> Since crypto trading pairs are a very common way of trading, the new regime could have a significant impact on retail trading on the platform.
<p>Investor Protection (paragraphs 9.1 – 9.33 of the VATP Guidelines)</p>	<p><i>Professional investor categorisation</i></p> <ul style="list-style-type: none"> • VATPs will be required to implement thorough measures to ensure investor protection. For these purposes, the SFC distinguishes between (i) institutional professional investors (e.g., financial institutions) and qualified corporate professional investors (i.e., companies which have been assessed to have appropriate procedures for making investment decisions) (together, Exempt Investors) and (ii) non-qualified corporate professional investors, individual professional investors, and retail clients. • Other than for Exempt Investors, VATPs will be required to: <ul style="list-style-type: none"> – assess the investors' knowledge of VAs before opening an account, and if the investor does not possess such knowledge, provide appropriate training before opening an account; – conduct know-your-client (KYC) steps to understand the clients' financial situation, investment experience, and investment objectives; – determine the clients' risk tolerance and risk profile; – set appropriate limits on exposure to VAs as is reasonable, with reference to the clients' financial situation and personal circumstances; and – enter into a written agreement with each client, which includes risk disclosure statements. <p>The SFC believes it is not appropriate to be prescriptive on how VATPs should implement exposure limits and determine risk tolerance levels for clients, but instead will issue frequently asked questions (FAQs) on how these should be assessed.</p> <ul style="list-style-type: none"> • VATPs will need to categorise clients and consider whether, and how, they intend to apply the regulatory exemptions.

Key Obligation	Description
	<p><i>Suitability</i></p> <ul style="list-style-type: none"> • The SFC will impose a suitability obligation on VATPs similar to the existing obligation under the securities regime. • This obligation will require VATPs to, other than when dealing with Exempt Investors, insert a <u>contractual suitability clause</u> into the client agreement. This clause will create a contractual obligation for VATPs to ensure — when <u>making a recommendation or solicitation to a client</u> — the suitability of the recommendation or solicitation and that it is reasonable for the client in the circumstances (having regard to the information which VATPs should be aware of). This contractual obligation is mirrored by an equivalent regulatory obligation. <ul style="list-style-type: none"> – The suitability obligation may be unfamiliar to those who have not operated within a securities regime, and will require platform operators to develop policies to ensure that VATPs: (i) determine the circumstances when making a solicitation or recommendation (taking into account system design and interface); (ii) do not inadvertently solicit or recommend VAs to clients (having regard to the context and impression created by the platform); and (iii) establish policies and procedures to assess the suitability of a VA for their clients. • In addition, other than when dealing with Exempt Investors, VATPs will be required to ensure a transaction in a complex product is suitable for the client in all the circumstances. <ul style="list-style-type: none"> – A “complex product” is a product whose terms, features, and risks are not reasonably likely to be understood by a retail investor because of its complex structure (e.g., derivative VA products, VAs where there is no secondary market, illiquid or difficult-to-value features, where the loss may exceed the investment amount). – However, this does not apply to orders of VAs which are placed by the client directly on the platform where there has been no solicitation or recommendation. <p><i>Disclosure</i></p> <ul style="list-style-type: none"> • VATPs will be required to act with due skill, care, and diligence when posting information and materials on their platforms and providing any information to clients. They should take all reasonable steps to disclose the nature and risks that clients may be exposed to when trading on the platform (except when dealing with Exempt Investors). They should also disclose information about the services, trading and operational rules, and fees and charges. • In respect of the VAs trading on the platform, VATPs will be required to disclose the price and trading volume on the platform, background information about the team or developer of the VA, a description of the VA, and the links to the VA’s official website and white paper. • VATPs will also be required to keep records and issue contract notes, statements of account, and receipts to the clients.
Senior Management / Corporate	<ul style="list-style-type: none"> • VATPs will be required to have two SFC-approved responsible officers (ROs), who will have general responsibility of overseeing the licensed entity’s operations and ensuring

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<p>Governance</p> <p>(paragraph 3.7 of the VATP Guidelines)</p>	<p>its compliance with AML/CFT and other regulatory requirements. At least one RO will need to be an executive director.</p> <ul style="list-style-type: none"> • VATPs will also need to appoint “Managers-in-Charge” (MIC) for core functions. The SFC will need to be notified of such designations so that it can understand the management structure of a VATP: <ul style="list-style-type: none"> – Overall management oversight – Key business line – Operational control and review – Risk management – Finance and accounting – Information technology – Compliance – Anti-money laundering and counter-terrorist financing <p>The SFC will be issuing further guidance in the form of FAQs on the appointment of MICs, which will be similar to the securities regime.</p>
<p>Fit and Proper Criteria</p> <p>(paragraphs 2.1 – 2.8 of the VATP Guidelines)</p>	<ul style="list-style-type: none"> • Similar to the securities and futures regime, the SFC will assess whether licensed individuals, directors, substantial shareholders, ultimate owners, or controllers are fit and proper to carry on the regulated activities and/or be associated with the licensed entity. • In the VATP Guidelines, the SFC has set out the factors it will consider in assessing fitness and propriety. These include reputation, character, and integrity, including whether they have been found to be dishonest or engaged in fraudulent or criminal activity.
<p>Competence Requirements for Staff</p> <p>(paragraphs 3.8 – 3.38; 4.1 – 4.28 of the VATP Guidelines)</p>	<ul style="list-style-type: none"> • The SFC will require ROs and licensed representatives (LRs) to meet competence requirements before they are approved with VATPs. • For ROs, this generally means (i) having a university degree in relevant business or law subjects; (ii) having at least three years of relevant industry experience over the past six years; (iii) having two years of management experience; and (iv) passing local regulatory exam papers Hong Kong Securities and Investment Institute (HKSI) Licensing Examination (LE) Papers 1 and 2. • For LRs, this generally means (i) having a university degree in relevant business or law subjects; and (ii) passing the local regulatory exam paper, HKSI LE Paper 1. • For persons who do not meet those requirements, other routes and exemptions will potentially be available.

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	<ul style="list-style-type: none"> The SFC will require VATPs to implement a continuous professional training (CPT) programme and ensure licensed individuals complete annual CPT hours to remain fit and proper.
<p>Financial Resources and Financials</p> <p>(paragraphs 6.1 – 6.12; 15.1 – 15.2 of the VATP Guidelines)</p>	<ul style="list-style-type: none"> VATPs will be required to comply with requirements related to financial resources and soundness. In particular, VATPs will be required to have: <ul style="list-style-type: none"> a minimum paid-up share capital of HK\$5 million (approx. US\$638,000) at all times; a minimum liquid capital of HK\$3 million (approx. US\$383,000); and assets in Hong Kong which they beneficially own and are sufficiently liquid (e.g., cash, deposits, treasury bills, and certificates of deposit (but not VAs), equivalent to at least 12 months of their actual operating expenses calculated on a rolling basis. VATPs will be required to calculate their capital requirement in accordance with the Securities and Futures (Financial Resources) Rules. Financial returns will be required to be submitted on a monthly basis. VATPs will be required to appoint an external auditor to perform audits of financial statements.
<p>Trading and Activity Restrictions</p> <p>(paragraphs 7.22 – 7.28; 8.1 – 8.4; 9.3; 13.1 – 13.4 of the VATP Guidelines)</p>	<p><i>Trading</i></p> <ul style="list-style-type: none"> VATPs should execute a trade only if the client's account has sufficient fiat currencies or VAs to cover that trade (except for any off-platform transaction to be conducted by institutional professional investors in respect of certain VAs and except under permitted circumstances specified by the SFC). VATPs should establish and implement policies and controls to supervise trading activities on their platforms to prevent market manipulative or abusive trading activities. They should also adopt an effective market surveillance system provided by a reputable and independent provider to identify, monitor, detect, and prevent any market manipulative or abusive activities on their trading platforms, and provide access to this system for the SFC when required. <p><i>Liquidity and Conflicts</i></p> <ul style="list-style-type: none"> VATPs will be permitted to onboard third-party market makers on the platform to provide liquidity services. Except as permitted by the SFC on a case-by-case basis, VATPs will not be permitted to engage in proprietary trading in VAs for its own account or any account in which it has an interest, other than "off-platform back-to-back transactions", which means transactions in which VATPs, taking no market risk, receive: <ul style="list-style-type: none"> a purchase order from a client, purchase a VA from a third party, and then sell it to the client; or a sell order from a client, purchase a VA from the client, and then sell it to a third party.

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	<p>A VATP should also ensure that any corporation within the same group of companies does not conduct any proprietary trading in VAs through the VATP (whether on-platform or off-platform) except for circumstances permitted by the SFC on a case-by-case basis.</p> <p><i>Restrictions</i></p> <ul style="list-style-type: none"> • VATPs will be required to implement measures to restrict persons from jurisdictions which have banned trading in VAs from accessing and trading on the platform (e.g., geo-blocking). This requirement will be particularly relevant from a Hong Kong perspective to persons located in Mainland China, as the Chinese government has banned VA-related activities. • VATPs will not be permitted to provide financial accommodation for clients to acquire VAs, and should generally not permit group companies to do so, unless in exceptional circumstances approved by the SFC on a case-by-case basis. • VATPs should not conduct any offering, trading, or dealing activities in VA futures contracts or related derivatives. <ul style="list-style-type: none"> – In the Consultation Paper, the SFC recognised that the industry is interested in offering VA derivatives (particularly for institutional investors). The SFC received feedback from the industry on the business models which participants would like to see. The SFC noted it will conduct a separate review in due course. • VATPs should not (i) provide algorithmic trading services to clients or (ii) use client VAs held on the platform to generate returns for clients or other parties. Therefore, VATPs should not carry on ancillary trading activities with deposited assets, such as providing staking-as-a-service for its clients.
<p>Custody (paragraphs 10.1 – 10.21 of the VATP Guidelines)</p>	<ul style="list-style-type: none"> • VATPs will be required to establish an “associated entity” to custody the client assets (i.e., client fiat currency or VA) on trust for the client. They will need to put in place appropriate procedures to adequately safeguard the client assets and protect client assets from theft, fraud, and other acts of misappropriation. Client assets will need to be segregated from proprietary assets. • VATPs should not deposit, transfer, lend, pledge, repledge, or otherwise deal with or create any encumbrance over the VAs of a client. They should also store 98% of client VAs in cold storage (such as Hardware Security Module (HSM)-based cold storage) except under limited circumstances permitted by the SFC on a case-by-case basis. • For VAs, strong internal controls will be required for private key management to ensure all cryptographic seeds and private keys are securely generated, stored, and backed up. These requirements include having distributed backups of seeds or private keys to prevent any single point of failure and storage of such seed and private keys in Hong Kong. • Strict measures will also need to be in place when dealing with client money, including placing client money within a segregated account maintained with a bank in Hong Kong (unless client money is received outside Hong Kong and the SFC approves alternate arrangements). Currently, many platforms find it difficult to open accounts with banks in Hong Kong. With additional guidance from the HKMA, the industry hopes that banks will feel more comfortable opening bank accounts for VATPs.

Key Obligation	Description
<p>Insurance and Compensation Arrangements</p> <p>(paragraphs 10.22 – 10.26 of the VATP Guidelines)</p>	<ul style="list-style-type: none"> VATPs have had difficulty obtaining insurance coverage, since few insurers are willing to provide coverage, and the insurance premiums can be prohibitive. The SFC will permit VATPs to implement compensation arrangements approved by the SFC to cover potential loss of 50% of client VAs in cold storage and 100% of client VAs in hot and other storage (e.g., hacking incidents or defaults by VATPs). The arrangements can include any combination of third party insurance, own funds, or VAs held on trust or a bank guarantee provided by a Hong Kong-licensed bank. Any subsequent changes in the compensation arrangement should be pre-approved by the SFC. In addition, if VATPs become aware that the total value of client VAs under custody exceeds the covered amount under the compensation arrangement approved by the SFC, then they should notify the SFC and take prompt remedial measures to ensure compliance with the compensation requirements.
<p>AML/CFT</p> <p>(AML/CFT Guidelines)</p>	<ul style="list-style-type: none"> In addition to the obligation to conduct customer due diligence on clients — which will be familiar to many financial institutions — the AMLO will provide for the implementation of the travel rule in Hong Kong. This requires financial institutions, including VATPs, to obtain and share relevant information on the originator and recipient of VA transfers and take other steps to mitigate money laundering / terrorist financing risks (including conducting due diligence on VA transfer counterparties). These rules will not be new to many global crypto exchanges, both licensed and unlicensed. These requirements are standardised and arise from the Financial Action Task Force’s recommendations, and have already been rolled out in other jurisdictions. <ul style="list-style-type: none"> Some respondents to the Consultation Paper noted that it may take time to develop systems to facilitate the immediate submission of the required information to a beneficiary institution. Where the required information cannot be submitted to the beneficiary institution immediately, the SFC considers that submission as soon as practicable after the virtual asset transfer to be acceptable as an interim measure until 1 January 2024. The revised AML/CFT Guidelines provide more guidance on how licensees should address money laundering and terrorism financing under a risk-based approach in respect of VAs. Use of blockchain analytic tools are mentioned as technological solutions which can help track VAs and identify potentially suspicious transactions. VATPs are also given discretion to adopt any technological solution which enables them to comply with the travel rule, although they will still be ultimately responsible for discharging their AML/CFT obligations.
<p>Cybersecurity</p> <p>(paragraphs 12.1 – 12.20 of the VATP Guidelines)</p>	<ul style="list-style-type: none"> The SFC has set out detailed guidance on its expectations around VATPs’ cybersecurity policies and procedures. This guidance covers areas including standard operating procedures, security measures, system and data backup, and contingency arrangements. The SFC will require at least one RO to be responsible for the overall management and supervision of its trading platform and for defining a cybersecurity management framework.

Key Obligation	Description
	<ul style="list-style-type: none"> VATPs will also be required to arrange a periodic (at least annual) technology audit by a suitably qualified independent professional to review compliance with the SFC's rules.
Other obligations	<ul style="list-style-type: none"> VATPs will be required to establish a wide range of policies and procedures to comply with their obligations. As noted below, VATPs will be required to have an external assessor review these policies and procedures to ensure they meet the SFC's standards. VATPs will also be required to comply with an extensive list of approval and notification obligations, some of which have been noted above. Among others, self-reporting and notification obligations will apply if: (i) the VATP has a significant change in business plan; (ii) the VATP falls below its minimum capital requirements; (iii) there are specified changes to the VATP, its licensed representatives, or ultimate owners; and (iv) the VATP becomes aware of any material breach of the applicable legal and regulatory requirements. Under the Disciplinary Guidelines, the SFC has provided additional guidance on how it will exercise its power of fining under the AMLO.

Transitional Period

This section describes the transitional arrangements which apply to pre-existing VA trading platform operating in Hong Kong immediately before 1 June 2023.

From 1 June 2023 onwards, any VA trading platform carrying on its business in Hong Kong or actively marketing its services to Hong Kong persons will need to obtain a VASP licence. However, the AMLO provides for a transitional period when the VASP regime comes into effect on 1 June 2023.

A pre-existing VA trading platform operating in Hong Kong immediately before 1 June 2023 will have a transition period so that it can either apply for a licence or close down in an orderly manner. For 12 months from 1 June 2023 (i.e., until 31 May 2024), the platform can continue to operate in Hong Kong without a licence.

The SFC has stated that it interprets pre-existing VA trading platform operating in Hong Kong to mean the VA trading platform must have a “meaningful and substantial presence”. To determine such presence, the SFC will consider, among other factors:

- whether it is incorporated in Hong Kong;
- whether it has a physical office in Hong Kong;
- whether its Hong Kong staff have central management and control over the VA trading platform;
- whether its key personnel (e.g., those responsible for the operation of the trading system) are based in Hong Kong; and
- whether the centralised trading platform's operation is live with a considerable number of clients and volume of trading activities in Hong Kong.

There is also a deeming arrangement for a pre-existing VA trading platform so that they can apply for a licence between 1 June 2023 and 29 February 2024, and obtain a deemed licence in the interim period while the SFC considers their application. In the licence application, the platform will be required to confirm and demonstrate that: (i) it has been operating a VA trading platform in Hong Kong immediately before 1 June 2023, and (ii) it will, on being deemed to be licensed, comply with the applicable regulatory requirements.

If the VA trading platform meets the deeming conditions, it will automatically be deemed to be licensed from 1 June 2024 (i.e., when the one-year non-contravention period expires) until its licence application is approved, withdrawn, or refused (whichever is earlier). The AMLO will apply to deemed licensees, and they will become subject to the SFC's supervisory regime.

Individuals who perform regulated functions in Hong Kong for qualified pre-existing VA trading platforms may also continue to operate in Hong Kong and will be subject to a deeming arrangement in connection with their application to be an RO or LR.

If a pre-existing VA trading platform does not wish to obtain a licence, then it should prepare to close down its business in Hong Kong in an orderly manner before 31 May 2024, and cease to actively market its services to Hong Kong persons.

The SFC received a number of questions during the consultation process about the transitional arrangements. It intends to issue further information on the transitional arrangements in the form of a circular.

Applying for a VATP Licence

As outlined in this section, to apply for a licence, the VASP will be required to complete the SFC's specified forms and engage an external assessor (or external assessors, if there is more than one) to submit reports to the SFC:

- **Phase 1:** When submitting the licence application, the external assessor will be required to review the design effectiveness of the operator's proposed structure, governance, operations, systems, and controls and assess if they comply with the applicable legal and regulatory requirements (Phase 1 Report).
- **Phase 2:** After approval-in-principle is granted by the SFC, the external assessor will be required to review and assess the implementation and effectiveness of the actual adoption of the planned policies, procedures, systems, and controls (Phase 2 Report). The SFC will grant final approval only if it is satisfied with the findings of the Phase 2 Report.

A number of questions were raised during the consultation process on the licensing process. The SFC intends to publish further guidance in the form of circulars, FAQs, and a licensing handbook for common questions relating to the new AMLO VASP regime.

Other VA Activities

This section looks at other VA activities in Hong Kong which fall outside of the existing securities and the VASP regime set out above.

Overall, many VA activities, such as providing non-exchange dealing and advisory activities related to VAs, remain largely unregulated in Hong Kong. Depending on the structure and nature of the activities,

there may be need to seek licensing under other regimes such as the trust and company service provider regime (for providing trust services) or the money service operator regime (for providing remittance or currency exchange services).

However, existing regulated financial institutions providing VA services or dealing with VAs will be subject to certain [regulations and guidance issued by the financial regulators](#).

As set out in a [Joint Circular published by the HKMA and the SFC in January 2022](#), existing banks and securities firms which carry on (or intend to carry on):

- distribution of VA-related products (e.g., listed and unlisted derivative or other products such as VA exchange-traded funds) will be subject to investor protection requirements. They are required to ensure that these products are only offered to professional investors (except for certain exchange-traded products), the investor has knowledge about VAs, and the suitability and complex regime is complied with.
- VA dealing services will be subject to terms and conditions placed their activities, including the requirement to partner with a SFC-licensed VA trading platform.
- VA discretionary management activities (e.g., managing a portfolio with the stated investment objective to invest in VAs or where it is intended to invest 10% or more of the gross asset value in VAs) will be subject to terms and conditions placed on their activities, modeled similarly to the existing fund manager requirements.
- VA advisory activities will be subject to investor protection measures to ensure the investor has knowledge about VAs and the suitability regime is complied with.

In the Consultation Conclusions, the SFC noted that it would revise the Joint Circular in the future to maintain consistency with the requirements implemented under the VATP Guidelines.

The SFC has also published circulars warning the Hong Kong public of the risks associated with [VA futures contracts](#), [non-fungible tokens](#) (NFTs), and [VA investment products](#), and noted that certain of these products could fall within the securities and futures regime (e.g., if structured as an collective investment scheme).

The Hong Kong Monetary Authority (HKMA) has also [issued guidance to banks](#) intending to engage in VAs and VASPs. The HKMA does not prohibit banks from incurring financial exposures related to VAs (e.g., through investments in VAs, lending against VAs as collateral), but will require banks to implement adequate risk management controls. From a prudential perspective, the [Basel Committee's standards for prudential treatment of cryptoasset exposures](#) issued in December 2022 will help provide additional guidance to banks calculating their institution's overall exposures to VAs. Banks are also expected to ensure that AML/CFT risks are mitigated by adopting a risk-based approach and conducting appropriate customer due diligence on VASPs.

Separately, as noted above, the HKMA intends to [bring stablecoins into the regulatory perimeter](#) by establishing a new framework for regulating entities carrying on in-scope activities for fiat-linked stablecoins. The target implementation date is 2023/2024, and the HKMA will issue a more detailed consultation in due course setting out its proposed approach.

For insurers, the Insurance Authority has issued guidance that they should evaluate and address risks (such as AML/CFT and cyber risks) associated with VA-related activities before providing services (e.g., accepting VAs as premium or providing coverage or benefits related to VAs). Insurers are expected to adopt a conservative approach and should deduct the value of VAs in full when deriving their solvency positions and not include VAs when calculating their asset maintenance requirements.

Concluding Observations and Next Steps

The SFC's framework for VA exchanges is one of the most comprehensive regulatory frameworks for VA platforms in the world at this time; it is not a simple AML/CFT registration regime like some other jurisdictions have adopted. It will require intensive preparation and investment cost to set up a trading platform capable of meeting the requirements, as well as hiring and training the right management and staff who satisfy the competence requirements and who understand their responsibilities under the regime. While the regime is strict in some places, the SFC has also given itself flexibility in other areas, e.g., insurance/compensation arrangements, token listing, and custody, so that it can adapt as the market develops.

The SFC has powerful tools to investigate potential misconduct and discipline individuals for breaches. In light of the recent collapses of well-known crypto operators, it is anticipated that such a rigorous regime will help restore investor confidence. Indeed, the global crypto regulatory regimes are likely to move towards and adopt Hong Kong-style investor protection measures, rather than become more *laissez-faire*, and Hong Kong may have a competitive advantage in being one of the forerunners in creating a comprehensive regulatory regime.

VA exchanges, both global and local, should determine whether (i) their activities may trigger the VATP licensing regime and/or (ii) they intend to apply for a VATP licence. Those wishing to obtain a licence should, if they are not already operating in Hong Kong, consider whether they have the desire and the resources to meet the requirements set out in the VATP Guidelines and the AML/CFT Guidelines. Those who do not wish to obtain a VASP licence should put in place measures to ensure they do not trigger the VASP licensing regime and/or prepare to close down business in Hong Kong.

Interested parties should also monitor future materials to be published by the SFC in relation to items where it has noted that it intends to further consult or provide direction (e.g., derivatives trading, trading of security tokens, guidance around onboarding and triggering the suitability obligation, and a list of complex products).

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