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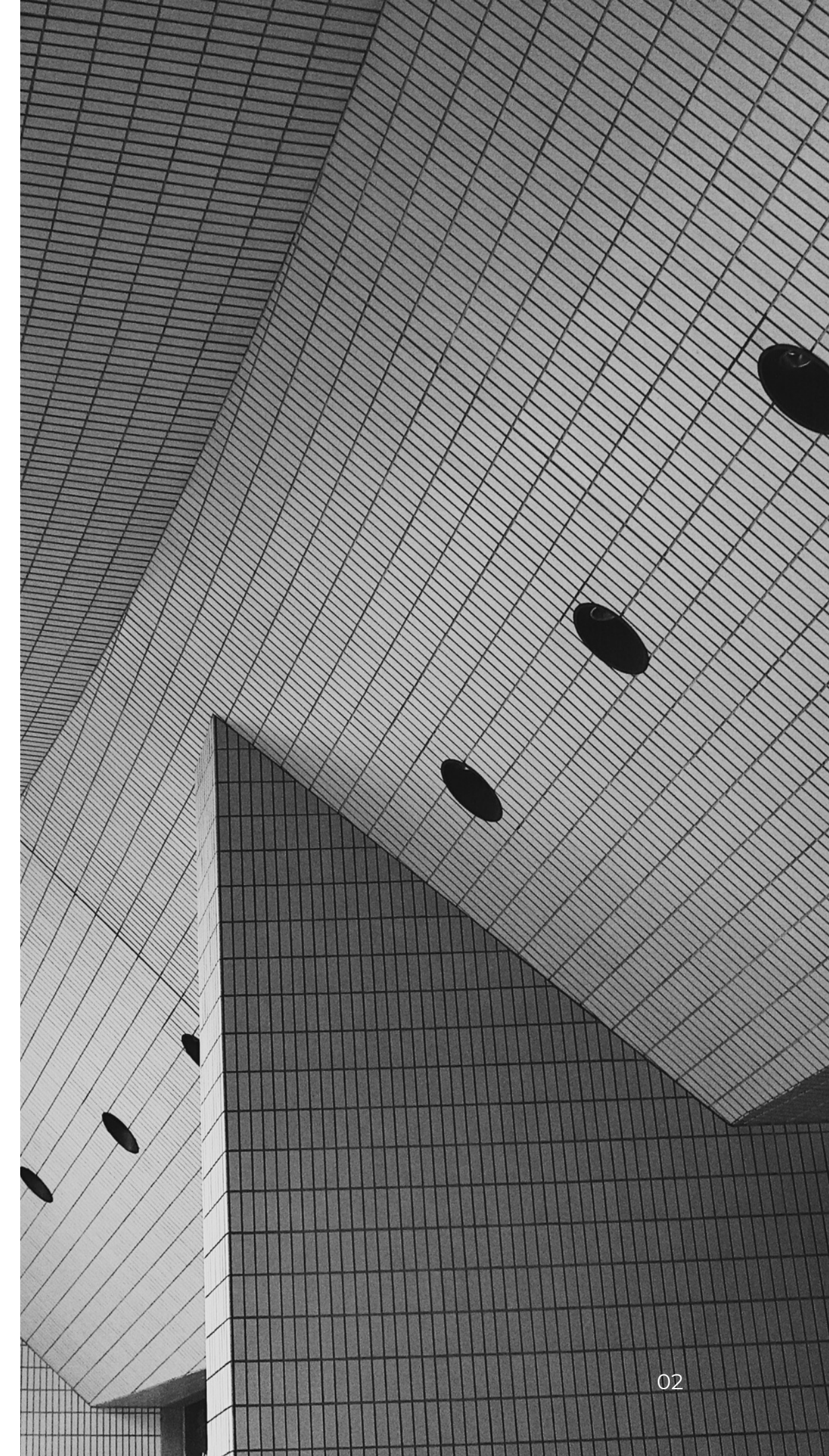
Webinar

**SFC CONSULTS ON PROPOSED  
REGULATORY REQUIREMENTS FOR  
HONG KONG LICENSED VIRTUAL ASSET  
TRADING PLATFORM OPERATORS**



# Background to Hong Kong's New Licensing Regime for VASPs

- Introduced to comprehensively regulate centralised VA trading platforms
- Effective on 1 June 2023 with dual licensing requirements under both the AMLO VASP regime and the existing SFO regime
- SFO regime regulates VA trading platforms trading security tokens (i.e. VA that are "securities" as defined in the SFO): AMLO VASP regime regulates VA trading platforms trading non-security tokens
- Includes regulatory requirements for safe custody, KYC, AML/CTF, conflict management, virtual asset admission criteria, prevention of market manipulation and abusive activities, risk management, and proper accounting and audit functions
- VATP Guidelines will supersede the existing regulatory requirements applicable to SFO-licensed platform operators (particularly, VATP Terms and Conditions)





# Who will require a licence for providing VA service?

- All centralised virtual asset trading platforms carrying on business in Hong Kong or actively marketing their services to Hong Kong investors, will need to be licensed irrespective of whether they provide trading services in security tokens
- VA trading platform operators that provide trading in non-security tokens need to obtain a licence for providing a VA service under s.53ZRK of the AMLO
- VA trading platform operators that provide trading in security tokens must obtain a licence for Type 1 (dealing in securities) and Type 7 (providing automated trading services) regulated activities under s.116 of SFO





# VASP Licensing Requirement under the AMLO

## Operating a Virtual Assets exchange

This is defined as providing services through means of electronic facilities:

(a) whereby:

(i) offers to sell or purchase virtual assets are regularly made or accepted in a way that forms or results in a binding transaction; or

(ii) persons are regularly introduced, or identified to others so that they can negotiate or conclude (or have a reasonable expectation of negotiating or concluding) sales or purchases of virtual assets; and

(b) where client money or client virtual assets comes into the direct or indirect possession of the person providing the service.





# What is the definition of “Virtual Assets”?

“Virtual assets” are defined in s. 53ZRA of the AMLO as a cryptographically secured digital representation of value that:

(i) is expressed as a unit of account or a store of economic value;

(ii) either:

- (a) is used, or intended to be used, as a medium of exchange accepted by the public for payment for goods or services, for the discharge of a debt and/or for investment; or
- (b) 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

(iii) can be transferred, stored or traded electronically.





## ✓ Virtual Asset

- Bitcoin
- Altcoin
- Stablecoin

## ✗ Virtual Asset

- Digital representations of fiat currencies
- Central bank digital currencies
- Financial assets already regulated under the SFO



# The VATP Guidelines

When the AMLO VASP licensing regime comes into effect, the Guidelines for Virtual Asset Trading Operators (VATP Guidelines) will apply to VA trading platforms licensed under the AMLO and/or the SFO - defined as "Platform Operators"

The VATP Guidelines extend the definition of "virtual assets" to include "securities tokens"

- "Securities tokens" = cryptographically secured digital representations of value which are "securities" under section 1 of Part 1 of Schedule 1 to the SFO





# Fit and Proper Test

## Factors to be considered by the SFC:

- Financial status or solvency
- Educational or other qualifications and experience
- Evidence of competence, honesty and financial integrity
- Any conviction history in Hong Kong or elsewhere for any money laundering or terrorist financing offence
- Failure to comply with any other applicable regulatory requirements





# General Principles Outlined in the VATP Guidelines

- Act honestly, fairly, with skill, care, and diligence
- Have and effectively employ necessary resources and procedures
- Seek relevant information from clients, including their financial situation, investment experience and investment objectives and assess their risk tolerance level and risk profile
- Provide clear and adequate disclosure of relevant material information when dealing with clients
- Avoid conflicts of interest and ensure fair treatment of clients
- Ensure the reliability and security of the trading platform
- Promptly account for and adequately safeguard client assets
- Senior management has primary responsibility for ensuring that appropriate standards of conduct are maintained and proper procedures are followed by the platform operators





# Whether Retail Investors should be allowed access to Licensed VA Trading Platforms

- VA trading platforms were initially restricted to professional investors only under the SFO regime
- Retail investors currently have limited access to regulated virtual asset-related products
- SFC is consulting on allowing licensed VA trading platforms to offer trading services to retail investors - subject to restrictions - including that only “eligible large-cap virtual assets” will be tradable by retail investors





# Onboarding requirements

## Current requirements

- Except for institutional and qualified corporate professional investors, platform operators must conduct knowledge assessments on investors before providing services, and provide training to those who do not pass the assessment

## Additional proposed safeguards for retail investors

- Assessing the client's risk tolerance level and risk profile to determine suitability for participation in virtual asset trading
- Setting a reasonable exposure limit for clients based on their financial situation and personal circumstances, which must be reviewed regularly to ensure it remains appropriate
- These safeguards will not apply to institutional and qualified corporate professional investors





# Suitability Obligation

Non-exhaustive factors to be considered when discharging suitability obligations:

- A holistic mechanism to assess the suitability of virtual assets for clients, including concentration risk
- Matching risk return profile of recommended virtual assets with the personal circumstances of the client
- Appropriate tools for assessing a client's concentration risk
- Diligent and careful provision of advice based on thorough analysis and having taken into account available alternatives
- Proper management and minimisation of conflicts of interest - no taking of commission rebates or other benefits as the primary basis for soliciting or recommending a VA to clients





## Solicitation or recommendation of VAs

- Platform operators are prohibited from posting advertisements for specific virtual assets
- Product-specific materials posted on the platform must be factual, fair, and balanced
- Except when dealing with institutional and qualified corporate professional investors (PIs), any solicitation/recommendation re. virtual assets must be reasonably suitable for the particular client
- Whether the suitability requirement is triggered is a matter of fact and should be assessed in light of all the circumstances leading up to the point of sale or advice
- Posting factual, fair and balanced product-specific materials would not in itself trigger the suitability requirement





# Solicitation or recommendation of complex products

- Virtual assets are "complex products" if their terms, features and risks are not easily understood by retail investors
- Except when dealing with institutional & qualified corporate PIs, platform operators should ensure the suitability of a complex products for the client & provide prominent and clear warning statements prior to and reasonably proximate to the point of sale or advice when dealing with complex products

## Examples of factors to consider when determining whether a virtual asset is "complex":

- whether it is a derivative product
- availability in a secondary market
- transparent information available to retail investors
- risk of losing more than the invested amount
- whether any features or terms of the virtual asset could fundamentally alter the nature or risk of the investment or pay-out profile, or include multiple variables or complicated formulas to determine the return
- illiquidity or difficulty in valuation because of the features or terms of the virtual asset





# Requirements Concerning Governance of Licensed VA Trading Platform Operators

## Token admission and review committee

- Committee should consist of senior management responsible for managing the key business line, compliance, risk management and information technology
- Committee's responsibilities include establishing, implementing and enforcing criteria for admitting, halting, suspending and withdrawing virtual assets from trading and the rules setting out obligations of virtual asset issuers
- The committee will make the final decision on virtual asset admission, halting, suspension and withdrawal based on criteria
- Committee will report to the board of directors at least monthly on (among others) virtual assets available for trading for retail clients
- Platform operators must notify clients as soon as practicable of any halt, suspension or withdrawal of a virtual asset from trading & inform holders of the virtual asset of available options





# TOKEN DUE DILIGENCE AND ADMISSION CRITERIA



# General token admission criteria

- Reasonable due diligence prior to admission of a virtual asset to trading
- Ongoing monitoring of virtual assets after admission

## Licensed VA trading platform operators to conduct reasonable due diligence on all virtual assets before admitting them to trading

- background of management/development team
- regulatory status in each jurisdiction in which the platform operators provide trading services
- supply, demand, maturity and liquidity
- technical aspects of the virtual asset
- quality of relevant marketing materials
- market risks
- legal risks





# Specific token admission criteria – only virtual assets that are “eligible large-cap virtual assets” are eligible for retail trading

## Eligible large-cap virtual asset

- Must be included in at least 2 acceptable indices issued by at least two independent index providers

## Acceptable indices

- Acceptable indices must have a clearly defined objective of measuring performance of largest VAs (e.g top 10), be investible, objectively calculated and rules-based
- At least one of the two indices should be issued by an index provider with a track record in publishing indices for the traditional non-virtual asset financial market





# Other Hong Kong token due diligence requirements

- Ensuring internal controls, systems, technology and infrastructure can support and manage virtual asset risks
- Conducting smart contract audits for virtual assets based on blockchains with a smart contract layer
- For virtual assets to be made available for retail trading, submission of a legal opinion or memorandum confirming virtual asset is not a "security"
- Submission of a proposal to the SFC for retail trading of a virtual asset fulfilling general token admission criteria but not specific token admission criteria to be assessed on a case-by-case basis





# Disclosure Obligations (I)

## Disclosure of adequate product information

- Price and trading volume of virtual assets on the platform
- Information about the virtual asset management team or developer
- Issuance date and a brief description of the virtual asset's terms and features
- Link to the virtual asset's official website (if any)
- Link to the smart contract audit report of the virtual asset (if any)
- Information on how voting rights of virtual assets will be handled by the platform operator (if applicable)





## Disclosure Obligations (II)

Except for institutional and qualified corporate professional investors, platform operators are required to disclose in full the risks that clients may be exposed to in trading virtual assets and using virtual asset trading services, including *inter alia*:

- virtual assets are highly risky and caution should be exercised when investing in them
- the legal status of virtual assets is uncertain and may affect the enforceability of a client's interest
- the offering documents or product information provided by the issuer has not been subject to regulatory scrutiny
- the Investor Compensation Fund does not cover virtual asset transactions, irrespective of the nature of the tokens
- virtual assets are not legal tender, and transactions may be irreversible, leading to unrecoverable losses
- virtual asset values may be completely lost if the market disappears, and legislative and regulatory changes may adversely affect their use, transfer, exchange and value
- virtual assets are more prone to fraud and cyberattacks due to their nature
- technological difficulties experienced by the platform operator may prevent clients from accessing their virtual assets





# Disclosure Obligations (III)

Minimum information that a platform operator should include on its website, including *inter alia*:

- adequate and appropriate information about its business
- its trading and operational rules as well as token admission and removal rules and criteria
- its admission and trading fees and charges
- the relevant material information for each virtual asset to enable clients to appraise the position of their investments
- the rights and obligations of the platform operator and the client
- arrangements for dealing with settlement failures in respect of transactions executed on its platform
- detailed documentation of market models, order types and trading rules as well as deposit and withdrawal processes for fiat currencies and virtual assets (where applicable)
- clients' liability for unauthorised virtual asset transactions
- circumstances in which the platform operator may disclose the client's personal information to third parties
- clients' right to prior notice of any change in the platform operator's rules, procedures or policies
- dispute resolution mechanisms, including complaints procedures
- the types of services that would only be available to professional investors





# SFC's proposed requirements for insurance or compensation arrangements

## Compensation Arrangement

- Licensed platform operators must establish an approved compensation arrangement providing an appropriate level of coverage for risks associated with the custody of client virtual assets
- Arrangements can include third-party insurance and/or funds set aside on trust and designated for such a purpose by the platform operator or any corporation within the same group of companies

## Monitoring of Virtual Assets

- Licensed platform operators must monitor the total value of client virtual assets under custody on a daily basis
- If the total value under custody exceeds the amount covered under the approved compensation arrangement and the situation is expected to persist, the platform operator must inform the SFC and take prompt remedial action





# Trading in virtual asset derivatives

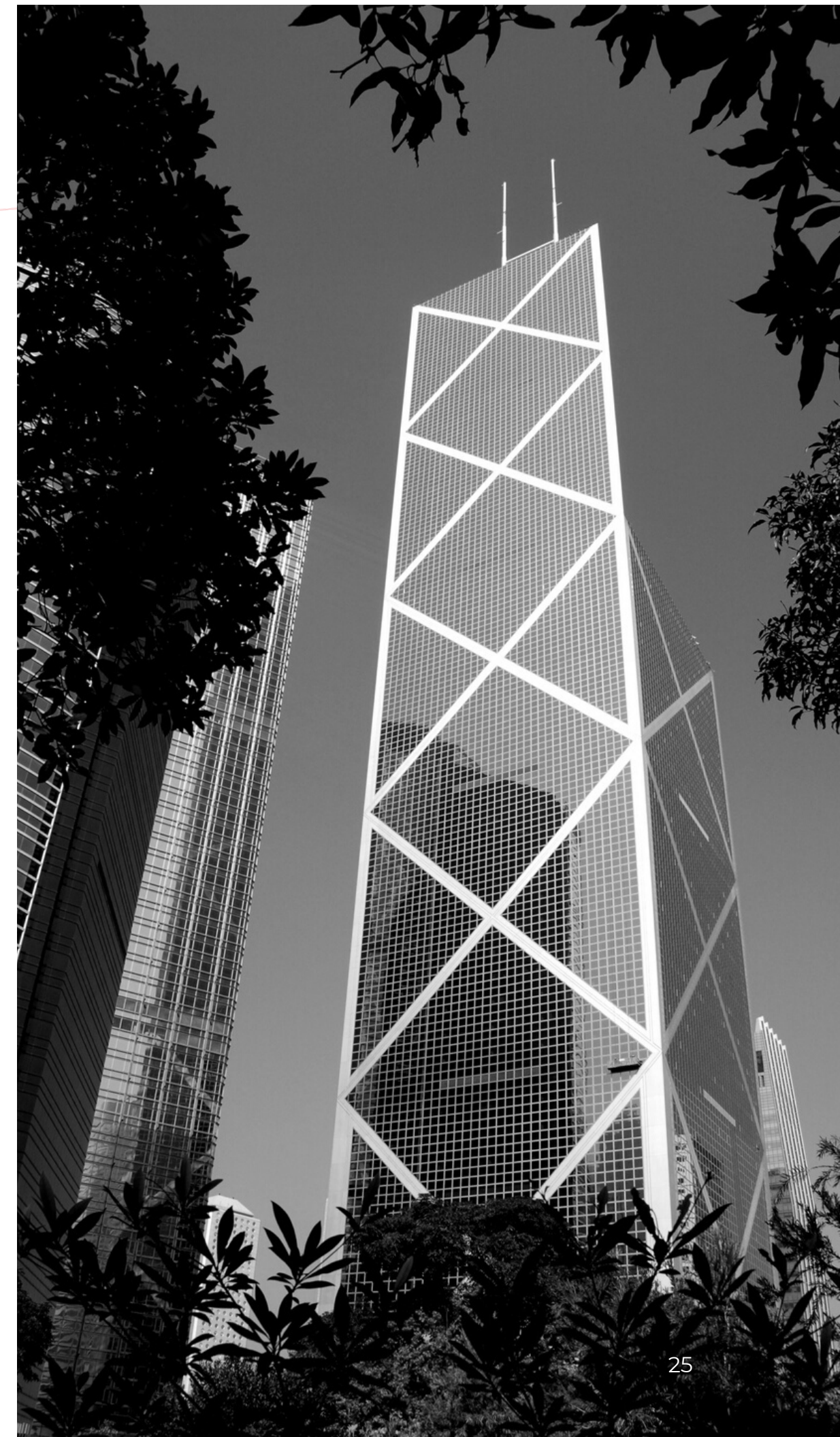
- Licensed VA trading platform operators in Hong Kong are not allowed to offer, trade or deal in virtual asset futures contracts or related derivatives under the existing SFO regime
- The SFC acknowledges the increased interest in offering virtual asset derivative products especially to institutional investors
- The SFC is consulting on the types of business models and virtual asset derivatives that licensed platform operators would offer as well as market demand





# Adaptations to existing requirements to be incorporated into the VATP Guidelines (I)

- Removal of the requirement for security tokens to be asset-backed, approved or qualified by, or registered for trading in comparable jurisdictions, and have a 12-month post-issuance track record
- No longer require a written legal opinion or memorandum on whether virtual assets are "securities", except where they are made available to retail clients
- Only required to disclose the handling of voting rights arising from client's ownership of a virtual asset, instead of being required to facilitate the exercise of such rights





# Adaptations to existing requirements to be incorporated into the VATP Guidelines (II)

## Proprietary trading

- Trading activities conducted for the account of the platform operator or any user which is a company within the same group of companies as the platform operator, trading as principal; or
- Any account in which the platform operator, or any user which is a company within the same group of companies as the platform operator, has an interest

## Exceptions to proprietary trading requirement:

- Back-to-back transactions off-platform
- Circumstances that are permitted by SFC on a case-by-case basis





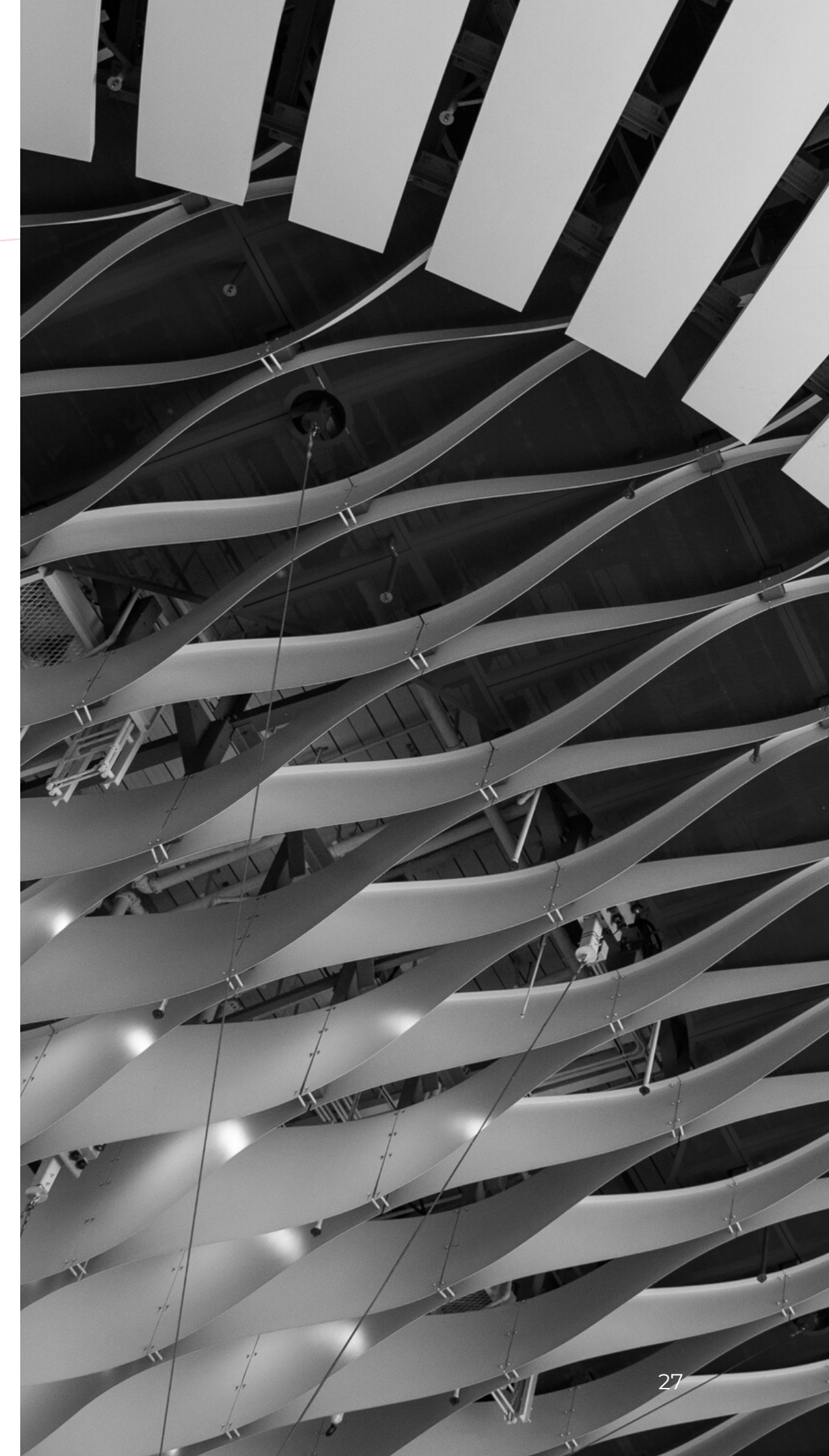
# Adaptations to existing requirements to be incorporated into the VATP Guidelines (III)

## Definition of back-to-back transactions:

- A type of transaction where a platform operator receives a purchase order from a client, purchases a virtual asset from a third party, and then sells the same virtual asset to the client
- Alternatively, in a sell order from a client, the platform operator purchases a virtual asset from the client and then sells the same virtual asset to a third party
  - No market risk is taken by the platform operator in these transactions

## Notification requirement for adding or removing VA products from trading platform

- Approval is not required if virtual assets are only available to professional investors
- SFC's prior written approval is required for virtual assets made available to retail clients





# Guideline on Anti-Money Laundering and Counter-Financing of Terrorism

- Additional virtual asset-specific AML/CTF requirements in Chapter 12 of the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and Licensed Virtual Asset Service Providers)
- Chapter 12 requirements are also applicable to licensed corporations not operating as platform operators if they are exposed to similar ML/TF risks





# Virtual asset transfers

The general principle is to apply wire transfer requirements under FATF Recommendation 16 to virtual asset transfers

- when acting as an ordering institution of virtual asset transfers, a licensed platform operator must obtain, record and submit the required information of the originator and recipient to the beneficiary institution immediately and securely
- when acting as a beneficiary institution, a licensed platform operator must obtain and record the required information submitted by the ordering institution or intermediary institution
- a licensed platform operator should conduct due diligence on a virtual asset transfer counterparty to identify and assess the associated ML/TF risks so as to apply risk-based AML/CTF measures
- when conducting virtual asset transfers to or from unhosted wallets, a licensed platform operator should obtain and record the required information from its customer who may be the originator or recipient; and should take reasonable measures to mitigate and manage the ML/TF risks associated with the transfers





# Requirements for the identification of suspicious transactions and sanctions screening in relation to virtual asset transfers

- Establish policies and procedures to identify and analyse any additional red flags of suspicious transactions and activities in connection with the screening of virtual asset transactions, the associated wallet addresses, and ongoing monitoring of additional customer information
- Implement an effective screening mechanism, including screening all relevant parties involved in virtual asset transfers
  - screening the recipient if the platform operator acts as the ordering institution or the virtual asset is transferred to an unhosted wallet
  - screening the originator if the VA trading platform operator acts as the beneficiary institution or the virtual asset is transferred from an unhosted wallet
  - screening both the originator and recipient if the platform operator acts as the intermediary institution.





# SFC Regulatory Powers under the AMLO

- A regulated person who is, or was at any time, guilty of misconduct, or the SFC considers that a regulated person is or was not a fit and proper person to be or to remain the same type of regulated person will be subject to a maximum fine of not exceeding the greater of (i) HK\$10,000,000; or (ii) 3 times the amount of the profit gained or loss avoided by the person as a result of the person's misconduct or of the person's conduct that led to the SFC forming the opinion that the person is not fit and proper

## Definition of "misconduct"

- Contravention of a material requirement, or conducting an act or omission relating to the provision of VA services which is, or is likely to be, prejudicial to the interests of the investing public or the public interest

## Examples of factors considered by the SFC for imposing a fine/penalty

- Whether the act was reckless, intentional or negligent
- Impact on market integrity and the reputation of Hong Kong as an international financial centre
- Duration and frequency of the conduct
- Whether the conduct is widespread in the relevant industry
- Whether significant costs have been imposed on, or losses caused to others, especially clients, market users or the investing public
- Whether there was a breach of fiduciary duty





# Transitional Arrangements for existing platform operators

- 12-month transitional period for SFO-licensed platform operators
- From 1 June 2023, any virtual asset trading platform carrying on business in non-security VAs in Hong Kong or marketing to Hong Kong investors without a valid AMLO licence will be in breach of AMLO VASP requirements, unless they are eligible for the transitional arrangements
- Platforms in operation in Hong Kong prior to 1 June 2023 with a meaningful and substantial presence are eligible for the transitional arrangements
  - Factors include
    - whether the platform is incorporated or has a physical office in Hong Kong
    - whether its central management and control over the platform and key personnel are based in Hong Kong
    - whether the trading platform is live with a considerable number of clients and volume of trading activities in Hong Kong





# Transitional Arrangements

## Proposed responsible officers

- To be eligible for the deeming arrangement as responsible officers, individuals must have been performing a regulated function in Hong Kong for a VA trading platform immediately before 1 June 2023 and at the time of application. However, the pre-existing VA trading platform for which the individual proposes to be the responsible officer does not have to be the same platform for which he or she was performing a function immediately before 1 June 2023

## Proposed licensed representatives

- For licensed representatives, individuals must be performing a regulated function in Hong Kong for the pre-existing VA trading platform at the time of application to qualify for the deeming arrangement





# Pre-existing VA trading platforms which intend to apply for a licence

## Eligibility Requirements

- Online submission of a fully completed licence application between 1 June 2023 and 29 February 2024
  - The platform must have been operating in Hong Kong before 1 June 2023
  - The platform must demonstrate that it has arrangements in place to ensure compliance with applicable regulatory requirements

## Unsuccessful Applications

- The SFC will notify applicants who do not meet the necessary conditions or who do not have a reasonable prospect of successfully showing they can comply with relevant legal and regulatory requirements
- Relevant VA trading platform must close down its business by 31 May 2024, or 3 months from the date of the SFC notice, whichever is later





# Pre-existing VA trading platforms which do not intend to apply for a licence / VA trading platforms already existing in Hong Kong

## Pre-existing VA trading platforms which do not intend to apply for a licence

- Pre-existing VA trading platforms that do not intend to apply for a licence must commence closing down their operations in an orderly manner

## VA trading platforms not already existing in Hong Kong

- VA trading platforms that do not operate in Hong Kong immediately before 1 June 2023 must not carry on business in Hong Kong or actively market their services to Hong Kong investors until they are formally licensed by the SFC under the AMLO VASP regime





# SFC Publication of Trading Platform Lists

The SFC will publish various lists on its website to inform the public of the regulatory status of VA trading platforms, including:

- List of licensed virtual asset trading platforms
- List of deemed licensed virtual asset trading platforms
- List of closing-down VA trading platforms
- List of unlicensed virtual asset trading platforms





# Dual Licensing

Upon the commencement of the new AMLO VASP licensing regime, the SFC will regulate (i) the trading of security tokens under the existing SFO regime; and (ii) the trading of non-security tokens by VA trading platforms under the AMLO VASP regime.

For platform operators applying for dual licences:

- Submission of a single consolidated application online which indicates that both licences are being applied for simultaneously

For SFO-licensed platform operators which currently provide trading in non-security tokens and platforms which have already applied for licences under the existing SFO regime:

- Submission of additional information required under the AMLO VASP regime



# External assessment report

## Phase 1 Report:

- Required at the time of submitting the licence application to the SFC
- Assessment of areas including governance and staffing, token admission, custody of virtual assets, KYC, AML/CTF, market surveillance, risk management and cybersecurity

## Phase 2 Report:

- Required after obtaining the approval-in-principle from the SFC
- Assessment should cover, *inter alia*:
  - Verification and confirmation that all external service providers (such as market surveillance tools, AML/CTF tools, and KYC tools) have been engaged
  - Vulnerability assessment to identify, rank and report potential vulnerabilities that may compromise a system
  - Penetration testing on network devices, firewalls, servers, databases, wallets and web applications
  - Confirmation that major/critical rectification steps have been taken for all medium to high risk items identified in the penetration and vulnerability tests





# Selection and appointment of external assessors

- Due skill, care and diligence should be exercised in the selection and appointment of the external assessor
- The VA trading platform operator could engage separate external assessors to review different areas of the business
- The external assessor should be independent of the applicant, its group or group companies
- The service provider of a particular system should not act as the external assessor for the same system
- The external assessor's capability statement should be submitted to the SFC together with the external assessment report