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Hong Kong Introduces Licensing Regime for Virtual Asset Services Providers

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On June 24, 2022, the Hong Kong Government gazetted the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 ("**Amendment Bill**")[1]. The Amendment Bill introduces changes to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) ("**AMLO**")[2], including the introduction of a licensing regime for virtual asset services providers ("**VASPs**") and imposing statutory anti-money laundering and counter-terrorist financing ("A**ML/CTF**") obligations on VASPs in Hong Kong. A Legislative Council Brief on the Amendment Bill ("**LegCo Brief**")[3] was also published on the same date, which provides valuable context for its introduction. The Amendment Bill follows the Consultation Conclusions[4] on this subject published by the Hong Kong government's Financial Services and Treasury Bureau on May 21, 2021, as discussed in our previous alert.[5]

As noted by the LegCo Brief, the Hong Kong government considers its proposed VASP regime to be '*more rigorous and comprehensive*' than the AML focused VASP regimes introduced in Singapore, the United Kingdom and Japan. To this end, and as discussed further below, the VASP regime is focused not only on AML related considerations but on ensuring adequate investor protection for virtual asset investors. As such, the VASP regime once implemented will not only impose a rigorous licensing regime on VASP operators, but will also criminalise a broad range of crypto-related misconduct, regardless of whether it takes place on a licensed VASP exchange. The regime also provides the SFC with an extensive range of supervisory powers.

I. Scope of proposed licensing regime for VASPs

As foreshadowed by the Consultation Conclusions last year, the Amendment Bill introduces a licensing regime for VASPs which provides that the business of operating a virtual asset ("**VA**") service is a "regulated function" requiring a license when undertaken in Hong Kong.[6]

The Amendment Bill defines "VA service" as only including the operation of a VA exchange,[7] which is defined as the provision of services through means of electronic facilities whereby:

- offers to sell or purchase VAs are regularly made or accepted in a way that forms or results in a binding transaction; or
- persons are regularly introduced, or identified to other persons in order that they may negotiate or conclude, or with the reasonable expectation that they will negotiate or conclude sales or purchases of VAs in a way that forms or results in a binding transaction; and
- where client money or client VAs comes into direct or indirect possession of the person providing such a service.

While the scope of services covered by this definition is comparatively narrow in comparison to other crypto licensing regimes such as the Singapore Payment Services

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Act, we anticipate that this category of "VA service" may be expanded in the future to extend the VASP regime to other crypto-asset activities. This is particularly likely given that the Amendment Bill provides that the amendment of this definition would not require legislative change, but could instead be achieved by the publication of a notice in the Government Gazette by the Secretary for Financial Services and the Treasury.[8]

Further, we note that the above definition included in the Amendment Bill is broader than the definition proposed under the Consultation Conclusions, which contemplated licensing '*any trading platform which is operated for the purpose of allowing an invitation to be made to buy or sell any VA in exchange for any money or any VA and which comes into custody, control, power or possession of, or over, any money or any VA at any time during the course of its business.*' As noted above, the Amendment Bill's definition of "VA service" now also captures electronic facilities through which '*persons are regularly introduced, or identified to other persons in order that they may negotiate or conclude, or with the reasonable expectation that they will negotiate or conclude sales or purchases of VAs in a way that forms or results in a binding transaction*'. This is particularly significant to operators of peer-to-peer exchanges, given that this definition appears to capture at least some peer-to-peer platforms where those platforms constitute facilities through which parties are regularly introduced for the purpose of, or with the reasonable expectation of, negotiating or concluding sales of VAs. This is in contrast to the Consultation Conclusions' statement that peer-to-peer trading platforms that only provide a forum where buyers and sellers of VAs can post their bids and offers "with or without automatic matching mechanisms" will not be covered under the definition of "VA exchange". As such, it will be important for operators of peer-to-peer exchanges to review their Hong Kong activities and carefully consider whether they do fall within this additional limb of "VA exchange" as included in the Amendment Bill. We anticipate that it also may be necessary to seek further guidance from the SFC regarding their position on peer-to-peer platforms as part of the consultation process which is expected to take place regarding the SFC's detailed regulatory requirements for the VASP regime. This consultation process is expected to take place during Q3-Q4 2022 once the Amendment Bill has been enacted and prior to the new regime taking effect.

The Amendment Bill has defined a "VA" as a digital representation of value that:

- is expressed as a unit of account or a store of economic value;
- either:
    - functions (or is intended to function) as a medium of exchange accepted by the public as payment for goods or services or for the discharge of debt, or for investment purposes; or
    - provides rights, eligibility or access to vote on the management, administration or governance of the affairs in connection with any cryptographically secured digital representation of value; and
- can be transferred, stored or traded electronically.[9]

Interestingly, the Consultation Conclusions did not contemplate the inclusion of the provision of rights, eligibility or access to vote as part of the definition of a "VA". However, this addition means that governance tokens will likely be considered to be a VA. Further, while not referenced by name in the Amendment Bill or Legco Brief, we consider that, in line with the Consultation Conclusions, the definition of "VA" will capture stablecoins. Finally, while the definition of a VA does not currently cover non-fungible tokens, the Amendment Bill provides that the Secretary for Financial Services and the Treasury may expand the categories of tokens captured by the "VA" definition by publication of a notice in the Gazette.[10]

II. Licensing requirements for licensed VASPs

In order to be eligible for a VASP license, the VASP license applicant must be a locally

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incorporated company with a permanent place of business in Hong Kong or a company incorporated elsewhere but registered in Hong Kong under the Companies Ordinance (Cap. 622).[11]

An applicant wishing to be licensed as a VASP must demonstrate to the Securities and Futures Commission ("**SFC**") that:

- it is a fit and proper person to be licensed to provide the VA service;
- it has at least 2 persons fit and proper to be responsible officers ("**ROs**"), each of whom are of sufficient authority within the applicant and at least one of whom must be an executive director;
- each director of the applicant is fit and proper; and
- the ultimate beneficial owner of the applicant is fit and proper to be the ultimate beneficial owner of a VASP licensee.[12]

The introduction of the fit and proper test is modelled on the fit and proper requirements for the licensing of regulated activities under the Securities and Futures Ordinance (Cap. 571) ("**SFO**").[13] Given this, it is unsurprising that the factors that the SFC will consider in evaluating the fitness and properness of VASP applicants and associated individuals (e.g. ROs, directors and ultimate beneficial owners) are the same as those factors set out in the SFO in relation to licensed corporations and registered institutions. These factors include whether the applicant has been convicted of offences relating to money laundering / terrorist financing, fraud, corruption or dishonesty; the applicant's financial status or solvency; its experience and qualifications; and its reputation, reliability and integrity.[14] Therefore, we recommend referring to the SFC's Fit and Proper Guidelines[15] to understand the matters that the SFC will likely consider in evaluating whether a person is fit and proper in relation to a VASP licensee.

III. Licensing conditions and AML/CTF requirements

The Amendment Bill provides that the SFC may impose a range of licensing conditions on a VASP licensee, including, but not limited to, requirements in relation to:

- Financial conditions (e.g. capital requirements);
- Risk management policies and procedures;
- Anti-money laundering and counter-terrorism financing policies and procedures;
- Management of client assets;
- Financial reporting and disclosure;
- Virtual asset listing and trading policies;
- Market abuse policies;
- Cybersecurity; and
- Avoidance of conflicts of interest.[16]

We anticipate further details regarding the nature of these licensing conditions will be provided by the SFC in its forthcoming consultation on the detailed regulatory requirements applicable to VASPs (as referred to above). However, it is interesting to note that the list of license conditions included in the Amendment Bill does not include categories of clients to whom the VASP licensee may provide services. This is in contrast to the LegCo Brief's statement that, in order to promote investor protection, the licensing regime will, at the initial stage, stipulate that VASPs can only provide services to professional investors ("**PIs**") and that this restriction would be imposed by the SFC as a license condition (which is in keeping with the approach taken by the SFC to imposing the same restriction on certain licensed corporations). We consider that the use of the phrase

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"initial stage" and taking this approach to the imposition of the PI only restriction (rather than enshrining it in the legislation itself) suggests that the SFC may possibly allow expansion of VASP services to retail investors down the track when VA markets become more mature and regulated. This would be a welcome development for the virtual asset industry and would bring the Hong Kong regime into line with comparable regimes globally, including the Singapore regime.

The Amendment Bill also provides that licensed VASPs must comply with the AMLO's requirements such as customer due diligence and record keeping requirements (e.g. Schedule 2 of the AMLO).[17]

IV. Key offences under the new VASP regime

The Amendment Bill also creates a significant new enforcement regime applicable to those providing VA services in Hong Kong or to the Hong Kong public. In particular, the Amendment Bill proposes that carrying on a business of providing a VA service without a license would be an offence punishable on conviction on indictment to a fine of HK$5 million and 7 years imprisonment, and in the case of a continuing offence, a further fine of HK$100,000 for every day during which the offence continues.

The Amendment Bill also introduces the following range of other offences punishable by significant fines and/or imprisonment:

- the offence of active marketing of a VA service by unlicensed persons, whether in Hong Kong or elsewhere, to the public of Hong Kong. This offence in particular is likely to have a significant impact on crypto exchanges based outside of Hong Kong and without a Hong Kong presence "on the ground" but which market their services to the Hong Kong public, including through, for example, Chinese language advertising;[18]
- the offence of making false or misleading statements in connection with an application for the grant of a license;
- the offence of making fraudulent or reckless misrepresentations with the intention to induce others to invest in VAs; and
- the offence of employing any deceptive or fraudulent device, scheme or act, directly or indirectly, in a transaction involving VA. We anticipate that this offence in particular will have a broad remit, given that it appears likely to extend to market manipulation and/or insider dealing in relation to virtual assets on the basis that such activities involve fraudulent and/or deceptive conduct.

Importantly, the offences of making fraudulent or reckless misrepresentations or employing deceptive or fraudulent devices, schemes or acts are not limited to transactions on licensed VASPs and as such will capture all individuals and/or firms engaging in this type of conduct with a substantial nexus to Hong Kong.

Finally, in the case of non-compliance with the statutory AML/CFT requirements, the licensed VASP and its ROs commit offences and upon conviction, each is liable to a fine of HK$1 million and 2 years imprisonment. Further, licensed VASPs and ROs in contravention may also face disciplinary actions, including suspension or revocation of licenses.

V. Supervisory powers granted to the SFC over licensed VASPs

The Amendment Bill also provides the SFC with broad supervisory powers over licensed VASPs, these include the power to enter business premises of the licensed VASP and its associated entities for conducting routine inspections of business records;[19] to request the production of documents and other records;[20] to investigate non-compliances and impose disciplinary sanctions against licensed VASPs in contravention.[21]

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The Amendment Bill also provides the SFC with a significant range of additional powers in relation to licensed VASPs, including:

- the power to appoint an auditor to investigate into the affairs of a licensed VASP and its associated entities if it has reasons to believe that the licensed VASP, or any of its associated entities, has failed to comply with provisions of the AMLO, code or guideline published under AMLO, or any licensing conditions imposed by the SFC;[22] and
- allowing the SFC to provide assistance to overseas regulators in investigations of any contraventions of VA requirements outside of Hong Kong. This is likely to be particularly significant given the global remit of many crypto businesses;[23] and
- powers to impose prohibitions or restrictions on the operation of a licensed VASP in a range of circumstances, including where the SFC considers the VASP not be fit and proper, or where there is a risk of dissipation of client assets.[24]

The Amendment Bill also provides the SFC with the power to seek certain orders from the Court of First Instance ("**CFI**") in relation to contraventions of the VASP regime, including contraventions of the AMLO, any notice given under the AMLO or any conditions of a license granted under the AMLO.[25] This includes, significantly, the power to apply to the CFI for an order compelling a person who has been, is or may become, involved in the commission of the aforementioned contraventions, to take any step that the CFI directs, including to restore parties to any transaction to the position in which they were before the transaction was entered into.[26] This could expose persons who are the subject of such orders to liability to provide significant investor compensation in relation to losses suffered as a result of contraventions of the AMLO. However, the Amendment Bill notably does not give the SFC the power to seek such orders in relation to contraventions of codes and guidelines issued under the AMLO, in contrast to the power being sought by the SFC at present in its current consultation on amendments to its power to seek certain orders from the CFI under section 213 of the SFO.

VI. Timing

The first reading of the Amendment Bill was due to take place on June 29, but that first reading has now been rescheduled to July 6, 2022, with the provisions relating to the VASP regime due to take effect on March 1, 2023.

While the Amendment Bill provides for transitional arrangements for providers of VA services, these transitional arrangements do not extend to the offences set out above in relation to fraudulent conduct in relation to transactions in VAs, which will take effect from March 1, 2023.

While the Consultation Conclusions had contemplated a transitional period of 180 days for providers of VA services, the Amendment Bill provides that:

- there will be a transitional period for the first 12 months for any corporation carrying on a business of operating a VA exchange in Hong Kong prior to March 1, 2023 (i.e. regardless of whether they apply for a license); and
- corporations carrying on a business of operating a VA exchange in Hong Kong immediately prior to March 1, 2023 that file an application for a VA in the first 9 months (i.e. license by December 1, 2023) will be deemed to be licensed from the day after the expiry of the 12 month transitional period (i.e. March 2, 2024) until the SFC has made a decision to either approve or reject their license application, or the license applicant withdraws their application.

As such, prospective license applicants should ensure that they are operating in Hong Kong prior to March 1, 2023 to ensure that they are entitled to these transitional arrangements.

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[1] Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022, available at: https://www.gld.gov.hk/egazette/pdf/20222625/es32022262516.pdf

[2] Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615), available at: https://www.elegislation.gov.hk/hk/cap615

[3] Legislative Council Brief Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 (June 22, 2022), published by the Financial Services and the Treasury Bureau, available at: https://www.fstb.gov.hk/fsb/en/legco/docs/AML(A)Bill%202022_legco%20brief_e%20(Issue).pdf

[4] Consultation Conclusions on Public Consultation on Legislative Proposal to Enhance Anti-Money Laundering and Counter-Terrorist Financing Regulation in Hong Kong (May 2021), published by the Financial Services and the Treasury Bureau, available at: https://www.fstb.gov.hk/fsb/en/publication/consult/doc/consult_conclu_amlo_e.pdf

[5] Licensing Regime for Virtual Asset Services Providers in Hong Kong, published by Gibson, Dunn and Crutcher (June 7, 2021), available at: https://www.gibsondunn.com/licensing-regime-for-virtual-asset-services-providers-in-hong-kong/#_ftn1

[6] Section 53ZRD(3), Amendment Bill

[7] Schedule B, Amendment Bill

[8] Section 53ZTL, Amendment Bill

[9] Section 53ZRA(1), Amendment Bill

[10] Section 53ZRA(4)(a), Amendment Bill

[11] Section 53ZRK(3)(a), Amendment Bill

[12] Section 53ZRK(3)(b), Amendment Bill

[13] See Section 129(1), Securities and Futures Ordinance (Cap. 571), available at: https://www.elegislation.gov.hk/hk/cap571

[14] Section 53ZRJ, Amendment Bill

[15] See SFC Fit and Proper Guidelines (January 2022), available at https://www.sfc.hk/-/media/EN/assets/components/codes/files-current/web/guidelines/fit-and-proper-guidelines/Fit-and-Proper-Guidelines.pdf

[16] Section 53ZRK(5), Amendment Bill

[17] Section 53ZRR, Part 3, Division 2, Paragraph 34, Amendment Bill

[18] We anticipate that the SFC will take a similar approach to “active marketing” in this context as it does to “active marketing” for the purposes of section 115 of the SFO. See, e.g., the SFC’s FAQ on this topic, available at: https://www.sfc.hk/en/faqs/intermediaries/licensing/Actively-markets-under-section-115-of-the-SFO#9CAC2C2643CF41458CEDA9882E56E25B

[19] Part 2, Division 2, Clause 11(1B), Amendment Bill

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[20] Part 2, Division 2, Clause 11(3), Amendment Bill

[21] Section 53ZSO, Amendment Bill

[22] Section 53ZSG, Amendment Bill

[23] Part 2, Division 2, Clause 18(13B) and (13C), Amendment Bill

[24] Sections 53ZSX, 53ZSY, 53ZSZ and 53ZT, Amendment Bill

[25] See our previous alert on this topic - Hong Kong SFC Consults on Significant Reforms to the SFO Enforcement Provisions, published by Gibson, Dunn and Crutcher (June 14, 2022), available at: https://www.gibsondunn.com/hong-kong-sfc-consults-on-significant-reforms-to-the-sfo-enforcement-provisions/

[26] Section 53ZTG, Amendment Bill

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Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. If you wish to discuss any of the matters set out above, please contact any member of Gibson Dunn's Crypto Taskforce (cryptotaskforce@gibsondunn.com) or the Global Financial Regulatory team, including the following authors in Hong Kong:

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