

Licensing Regime for Virtual Asset Services Providers in Hong Kong

Client Alert | June 7, 2021

On 21 May 2021, the Hong Kong government published the Consultation Conclusions^[1] on legislative proposals to enhance anti-money laundering and counter-terrorist financing (“AML/CTF”) regulations in Hong Kong, including a proposal to introduce a licensing regime for virtual asset services providers (“VASPs”). This client alert discusses the proposed scope of the licensing regime, the proposed regulatory requirements for licence holders, implications for cryptocurrency trading platforms, and opportunities for the future development of such trading platforms in Hong Kong.

Note that the discussions in this alert are based on the Consultation Conclusions. While unlikely, there could still be further changes in the drafting of the legislation before the laws are passed. Importantly there will be further public consultation before the detailed regulatory regime for licence holders, including applicable guidelines, are published, as discussed below.

Related People

[Connell O'Neill](#)

[Sébastien Evrard](#)

[Arnold Pun](#)

I. Why introduce a licensing regime for VASPs?

In recent years, the world has seen tremendous growth in the trading of virtual assets (“VAs”) including cryptocurrencies like bitcoin. This drew the attention of the Financial Action Task Force (“FATF”), which expressed concern about the perceived money laundering and terrorist financing (“ML/TF”) risks arising from the growing use of VAs. To address these ML/TF risks, the FATF updated the FATF Standards in February 2019^[2] to require jurisdictions to subject VASPs to the same range of AML/CTF obligations as financial institutions. To fulfil its obligations as a member of FATF, the Hong Kong government launched a public consultation on 3 November 2020.^[3] Amongst other things, the consultation proposed amendments to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (“AMLO”) to introduce a licensing regime for VASPs. The public consultation period ended on 31 January 2021, and the Consultation Conclusions were published on 21 May 2021.

II. Scope of proposed licensing regime for VASPs

The proposed licensing regime for VASPs would designate the business of operating a VA exchange as a “regulated VA activity”. As such, any person seeking to operate a VA exchange in Hong Kong would be required to apply for a licence^[4] from the Hong Kong Securities and Futures Commission (“SFC”) to become a licensed VASP under the AMLO. The granting of the licence would be subject to meeting the SFC’s fit-and-proper test and other regulatory requirements, which we discuss further below.

The proposed definition of a “VA exchange” is 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
- Comes into custody, control, power or possession of, or over, any money or any VA at any time during the course of its business.

Accordingly, a peer-to-peer trading platform would not fall within the definition of a VA exchange provided that the actual transactions in VAs are conducted outside the platform and the platform is not involved in the underlying transaction by coming into possession of any money or any VA at any point in time (i.e. platforms that only provide a forum for buyers and sellers to post their bids and offers, where the parties themselves transact outside the platform). As such, on the basis of the current drafting, it is possible that decentralised exchanges (“DEXs”) that operate on the basis of non-custodial storage (as opposed to centralised exchanges where users give up custody of their assets to the exchange) and without a centralised entity in charge of the order book, may not ultimately be caught by the definition of a VA exchange.

The proposed definition of “VA” means a digital representation of value that:

- Is expressed as a unit of account or a store of economic value;
- 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; and
- Can be transferred, stored or traded electronically.

The definition of “VA” is therefore likely to include cryptocurrencies such as bitcoin and VAs backed by another asset for the purpose of stabilising its value (i.e. stablecoins). On the other hand, the definition of VA would not cover:

- Digital representations of fiat currencies (such as digital currencies issued by central banks);
- Financial products already regulated under the Securities and Futures Ordinance (“SFO”);
- Closed-loop, limited purpose items that are non-transferable, non-exchangeable and non-fungible (e.g. air miles, credit card rewards, gift cards, customer loyalty points, gaming coins, etc.); and
- Stored value facilities which are regulated under the Payment Systems and Stored Value Facilities Ordinance.

Depending on the final drafting of the legislative amendment to introduce the licensing regime for VASPs, it appears that non-fungible tokens (“NFTs”) may fall outside the definition of “VA”. In that scenario NFT trading platforms would also fall outside the scope of the licensing regime

III. Implications for non-Hong Kong cryptocurrency exchanges

The proposed licensing regime for VASPs would also extend to VA exchanges which operate outside of Hong Kong, but which actively market to the public of Hong Kong. This means that a cryptocurrency exchange that is based outside of Hong Kong will be prohibited from ‘actively marketing’ regulated VA activity (i.e. operating a VA exchange) to the public of Hong Kong unless they are a licensed VASP. This would be similar to existing prohibitions under the SFO^[5] on actively marketing regulated activities to the public of Hong Kong (see below). In the context of the SFO, the meaning of actively markets is potentially broad, with some guidance available from the SFC^[6] and in case law on its interpretation.

IV. Crypto assets which are securities or futures contracts are already regulated under the SFO

It is important to note that financial products which are already regulated under the SFO would not fall within the definition of “VA”, and therefore trading platforms which enable trading in such products would not fall within the licensing regime for VASPs. An example

of such financial products is bitcoin futures which, depending on its terms and features, would likely either fall within the definition of “securities” or “futures contracts” under the SFO (and therefore would not be considered VAs).[\[7\]](#)

However, such trading platforms may already fall within the SFO regulatory regime for providing automated trading services, if it operates in or from Hong Kong, or actively markets to the public in Hong Kong (even if the platforms are based outside of Hong Kong). In this respect, in November 2019, the SFC published a position paper[\[8\]](#) which outlined the regulatory standards for the licensing of trading platforms that enable trading of crypto assets which have “securities” features.

V. Proposed licensing requirements for licensed VASPs

- Eligibility: applicants must either be incorporated in Hong Kong, or non-Hong Kong incorporated companies which are registered in Hong Kong under the Companies Ordinance.
- Fit-and-proper test: in considering whether or not an applicant is fit-and-proper to be granted a VASP licence, the SFC will take into account, among other matters, whether or not the applicant has been convicted of an ML/TF offence or other offence involving fraud, corruption or dishonesty, their experience and qualifications, their good standing and financial integrity, etc. This fit-and-proper test is likely to be very similar to, if not derived from, the well-established fit-and-proper test which applicants are required to satisfy to be granted a regulated activity licence under the SFO.
- Two responsible officers: as with any firm currently licensed by the SFC, applicants will need to appoint at least two responsible officers to assume the responsibility of ensuring compliance with AML/CTF and other regulatory requirements, who may be held personally accountable in case of non-compliance.

VI. Regulatory requirements for licensed VASPs

Licensed VASPs will be subject to the AML/CTF requirements stipulated in Schedule 2 of the AMLO (i.e. the same as financial institutions), including customer due diligence and record-keeping requirements.

In addition to AML/CTF requirements, licensed VASPs will also be subject to regulatory requirements designed to protect market integrity and investor interests. These requirements will be set out in codes and guidelines to be published by the SFC. Licensed VASPs would be required to comply with these requirements under licensing conditions imposed by the SFC. These requirements are likely to be wide-ranging in scope, with prescribed requirements covering, among other things, financial resources, risk management, segregation and management of client assets, financial reporting, prevention of market manipulative and abusive activities, prevention of conflicts of interest, etc.

Notably, licensed VASPs will only be able to provide services to professional investors, i.e. high net worth and institutional investors. This means that after the commencement of the licensing regime for VASPs, licensed VASPs cannot provide services to retail investors.

VII. Supervisory powers of the SFC over licensed VASPs

The SFC will be given broad powers to supervise the AML/CTF and regulatory compliance of licensed VASPs. This will include powers to enter business premises, to request the production of documents and records, to investigate non-compliance and to impose sanctions (including orders for remedial actions, civil penalties and suspension or revocation licence) for non-compliances. The SFC will also have intervention powers to impose restrictions and prohibitions against the operations of licensed VASPs and their associated entities where the circumstances warrant, such as to prohibit further

transactions or restrict the disposal of property. These powers enable the SFC to protect client assets in the event of emergency and to prevent the dissipation of client assets in the case of misconduct by a licensed VASP.

VIII. Timing

The Hong Kong government aims to introduce the AMLO amendment bill into the Legislative Council in the 2021-22 legislative session, which is due to commence in October 2021. The SFC will also prepare and publish for consultation the regulatory requirements for licensed VASPs, before commencement of the licensing regime for VASPs. Considering the above, the licensing regime is unlikely to commence before 2022. In any event there will be a 180-day transitional period from the commencement of the licensing regime to facilitate licence applications by interested parties.

IX. Conclusion

While the primary motivation for introducing the licensing regime for VASPs is to ensure that Hong Kong meets the latest FATF Standards, the Hong Kong authorities are also focused on promoting the protection of market integrity and investor interests, and the regulatory requirements for licensed VASPs extend beyond AML/CTF requirements by seeking to regulate matters including customer type (i.e. professional investors only), prevention of market manipulative and abusive activities, and prevention of conflicts of interest.

As Mr. Christopher Hui, Secretary for Financial Services and the Treasury, recently said in his remarks at a fintech forum,^[9] the introduction of the licensing regime for VASPs is intended to facilitate the development of such an industry by providing a clear regulatory framework for the industry to operate within. Notably, the original proposal for the licensing regime has now been amended to allow non-Hong Kong companies to apply for a VASP licence^[10] which may help to attract overseas crypto asset trading platforms that wish to develop their business within the Hong Kong regulatory framework.

For current VASPs contemplating applying for a VA licence when the licensing regime commences, we would recommend starting by reviewing their existing AML/CTF policies and systems and controls to identify gaps with the requirements under Schedule 2 of the AMLO. This is because these requirements are unlikely to be significantly modified during the legislative process, and it may take time and resources to design and implement. VASPs should also be alert to future consultations by the SFC on the codes and guidelines for licensed VASPs in order to identify the detailed regulatory requirements which licensed VASPs would need to comply with. Implementing these requirements will likely require preparing written policies and procedures, upgrading systems and controls, and potentially restructuring aspects of their business and operations to address potential conflicts of interest.

[1] *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/fstb/en/publication/consult/doc/consult_conclu_amlo_e.pdf

[2] *Public Statement – Mitigating Risks from Virtual Assets* (22 February 2019), published by FATF, available at: <https://www.fatf-gafi.org/publications/fatfrecommendation/documents/regulation-virtual-assets-interpretive-note.html>

[3] *Government launches consultation on legislative proposal to enhance anti-money laundering and counter-terrorist financing regulation* (3 November 2020), Hong Kong government press release, available at: <https://www.info.gov.hk/gia/general/202011/03/P2020110300338.htm>

GIBSON DUNN

[4] There will be an exception for a VA exchange that is already regulated as a licensed corporation in the voluntary opt-in regime supervised by the SFC pursuant to the SFO.

[5] Section 115 of the SFO.

[6] "Actively markets" under section 115 of the SFO (last updated 17 March 2003), published by the SFC, available at:
<https://www.sfc.hk/en/faqs/intermediaries/licensing/Actively-markets-under-section-115-of-the-SFO/#9CAC2C2643CF41458CFDA9882E56E25B>

[7] *Circular to Licensed Corporations and Registered Institutions on Bitcoin futures contracts and cryptocurrency-related investment products* (11 December 2017), published by the SFC, available at:
<https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=17EC79>

[8] *Position paper: Regulation of virtual asset trading platforms* (6 November 2019), published by the SFC, available at:
<https://www.sfc.hk/-/media/EN/files/ER/PDF/20191106-Position-Paper-and-Appendix-1-to-Position-Paper-Eng.pdf>

[9] Secretary for Financial Services and the Treasury, Mr. Christopher Hui, remarks at StartmeupHK Festival - Virtual FinTech Forum on 27 May 2021, available at:
https://www.news.gov.hk/eng/2021/05/20210527/20210527_131949_094.html

[10] The non-Hong Kong incorporated company would need to be registered in Hong Kong under the Companies Ordinance.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. If you would like to discuss further, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Financial Institutions practice group, or the following authors:

Connell O'Neill – Hong Kong (+852 2214 3812, coneill@gibsondunn.com)
Sébastien Evrard – Hong Kong (+852 2214 3798, sevrard@gibsondunn.com)
Arnold Pun – Hong Kong (+852 2214 3838, apun@gibsondunn.com)

Please also feel free to contact any of the following practice leaders and members:

Matthew L. Biben – New York (+1 212-351-6300, mbiben@gibsondunn.com)
Michael D. Bopp – Washington, D.C. (+1 202-955-8256, mbopp@gibsondunn.com)
Stephanie Brooker – Washington, D.C. (+1 202-887-3502, sbrooker@gibsondunn.com)
[M. Kendall Day](#) – Washington, D.C. (+1 202-955-8220, kday@gibsondunn.com)
Mylan L. Denerstein – New York (+1 212-351- 3850, mdenerstein@gibsondunn.com)
Michelle M. Kirschner – London (+44 (0) 20 7071 4212, mkirschner@gibsondunn.com)
Arthur S. Long – New York (+1 212-351-2426, along@gibsondunn.com)
Matthew Nunan – London (+44 (0) 20 7071 4201, mnunan@gibsondunn.com)
Jeffrey L. Steiner – Washington, D.C. (+1 202-887-3632, jsteiner@gibsondunn.com)

© 2021 Gibson, Dunn & Crutcher LLP

Attorney Advertising: The enclosed materials have been prepared for general informational purposes only and are not intended as legal advice.

Related Capabilities

[Financial Institutions](#)

[Financial Regulatory](#)

