



New licensing regime for Virtual Asset Service Providers in Hong Kong

mazars

Introduction

Virtual Assets (“VA”) and VA-related activities are becoming increasingly popular in Hong Kong, in particular to the retail sector. However, the existing regulations for VA, their related activities and Virtual Assets Service Providers (“VASP”) may not be sufficient to cover all VASPs which are providing VA-related activities to the Hong Kong public. In this regard, the Anti-Money Laundering and Counter-Terrorist Financing (“AML/CTF”) (Amendment) Bill 2022 has been recently gazetted in June 2022 to introduce a new licensing regime for VASP.

Before the introduction of the abovementioned VASP licensing regime, the Securities and Futures Commission (“SFC”) introduced a voluntary licensing regime in November 2019 for VA trading platform operators who choose to be regulated. This marks the first step taken by regulators in Hong Kong in supervising VA and VA-related activities.

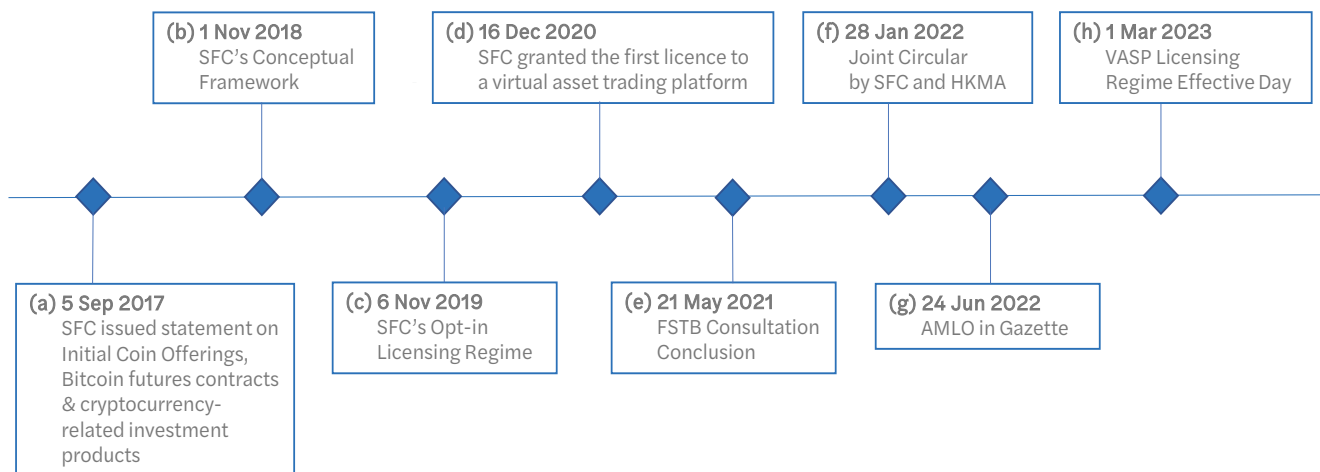
In January 2022, the SFC, together with the Hong Kong Monetary Authority (“HKMA”), issued a joint circular to impose additional regulatory requirements on license corporations and registered institutions which carry out VA-related product distribution, dealing services and advisory services, to increase the regulatory net on VA and VA-related activities conducted in Hong Kong.

This publication outlines the key elements of the new VASP licensing regime and how our financial advisory service offerings can assist you in preparing for the new regime.

New VASP licensing regime

1. Key regulatory events

The chart below is a timeline of the key events of regulations of VA-related activities in Hong Kong:



- (a) On **5 September 2017**, the SFC issued a statement on initial coin offerings, Bitcoin futures contracts and cryptocurrency-related investment products, clarifying its regulatory position. Since then, the SFC has been exploring a more comprehensive framework to cope with the risks associated with virtual assets.
- (b) On **1 November 2018**, the SFC announced its conceptual framework for the potential regulation of virtual asset trading platform operators, drawing up the core principles and proposed terms and conditions for the future developments, with an aim to provide virtual asset investors in Hong Kong with more protections.
- (c) On **6 November 2019**, the SFC issued a position paper to announce its opt-in licensing regime, seeking to bring virtual asset trading platforms which were interested in being licensed into its regulatory net. A centralised virtual asset trading platform offering trading of at least one security token in Hong Kong could apply for a Type 1 (Dealing in Securities) and Type 7 (Providing Automated Trading Services) licence.
- (d) On **16 December 2020**, the SFC granted the first licence to a virtual asset trading platform in Hong Kong.
- (e) In response to the Financial Action Task Force (“**FATF**”) requirement in 2019 of subjecting VASPs to the same range of AML/CTF obligations that are currently applicable to financial institutions and designated non-financial businesses and professions like casinos, accounting professionals etc., on **21 May 2021**, the Financial Services and the Treasury Bureau (“**FSTB**”) issued its consultation conclusion for a new licensing regime for VASPs, seeking to broaden the SFC’s authority to supervise and regulate a wider range of VA-related activities.



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1. Key regulatory events (con't)

- (f) Given the rapid-evolving VA landscape, increasing number of enquiries from intermediaries about distribution of VA-related products and intermediaries' interest in providing VA dealing services to their clients, on **28 January 2022**, the SFC and HKMA issued a joint circular on intermediaries' VA-related activities, setting out additional investor protection measures for licensed corporations and registered institutions conducting VA-related activities.
- (g) The Hong Kong Government published in the Gazette on **24 June 2022** the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 which include the introduction of the new VASP licensing regime.
- (h) The new licensing regime for VASP will come into effect on **1 March 2023**.

We will further discuss the coverage, licensing criteria, ongoing regulatory requirements, and implementation timeline of the new licensing regime for VASP in sections 2, 3, 4 and 5 of this publication respectively.

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2. Coverage

Under the amended AMLO, any person who seeks to carry on a business of providing VA service will be required to apply for a licence from the SFC. Referring to the fundamental components in the definition of the FATF's, the amended AMLO will define "Virtual Asset" and "VA Service" as set out in the table below.

Virtual Asset	VA Service
<ul style="list-style-type: none"> ▪ a cryptographically secured digital representation of value that— <ol style="list-style-type: none"> I. is expressed as a unit of account or a store of economic value; II. either— <ol style="list-style-type: none"> (a) is used, or is intended to be used, as a medium of exchange accepted by the public, for any one or more of the following purposes— <ol style="list-style-type: none"> i. payment for goods or services; ii. discharge of a debt; iii. 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; III. can be transferred, stored or traded electronically; and IV. satisfies other characteristics prescribed by SFC; or ▪ a digital representation of value prescribed as a virtual asset by notice published in the Gazette by the Secretary for Financial Services and the Treasury. 	<p>Operating a VA exchange, that is to say, providing services through means of electronic facilities</p> <ul style="list-style-type: none"> ▪ whereby— <ol style="list-style-type: none"> 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 other persons in order that they may negotiate or conclude, or with reasonable expectation that they will negotiate or conclude sales or purchases of virtual assets in a way that forms or results in a binding transaction; and ▪ where client money or client virtual assets comes into direct or indirect possession of the person providing such service.
Exclusions	
<p>A digital representation of value is excluded from the definition of VA above if it—</p> <ol style="list-style-type: none"> I. is issued by a central bank or by an entity that performs the functions of central bank or by an entity authorized by a central bank on its behalf; or II. is issued by a government of a jurisdiction, or by an entity authorized by the government of a jurisdiction and acting pursuant to an authority to issue currency in that jurisdiction; III. is a limited purpose digital token; IV. constitutes securities or a futures contract; V. constitutes any float or Small Value Facilities deposit of a stored value facility as defined by section 2 of the Payment Systems and Stored Value Facilities Ordinance (Cap. 584); or VI. satisfies other characteristics prescribed by SFC which precludes a digital representation of value being a VA 	

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3. Licensing criteria

Corporate structure and location

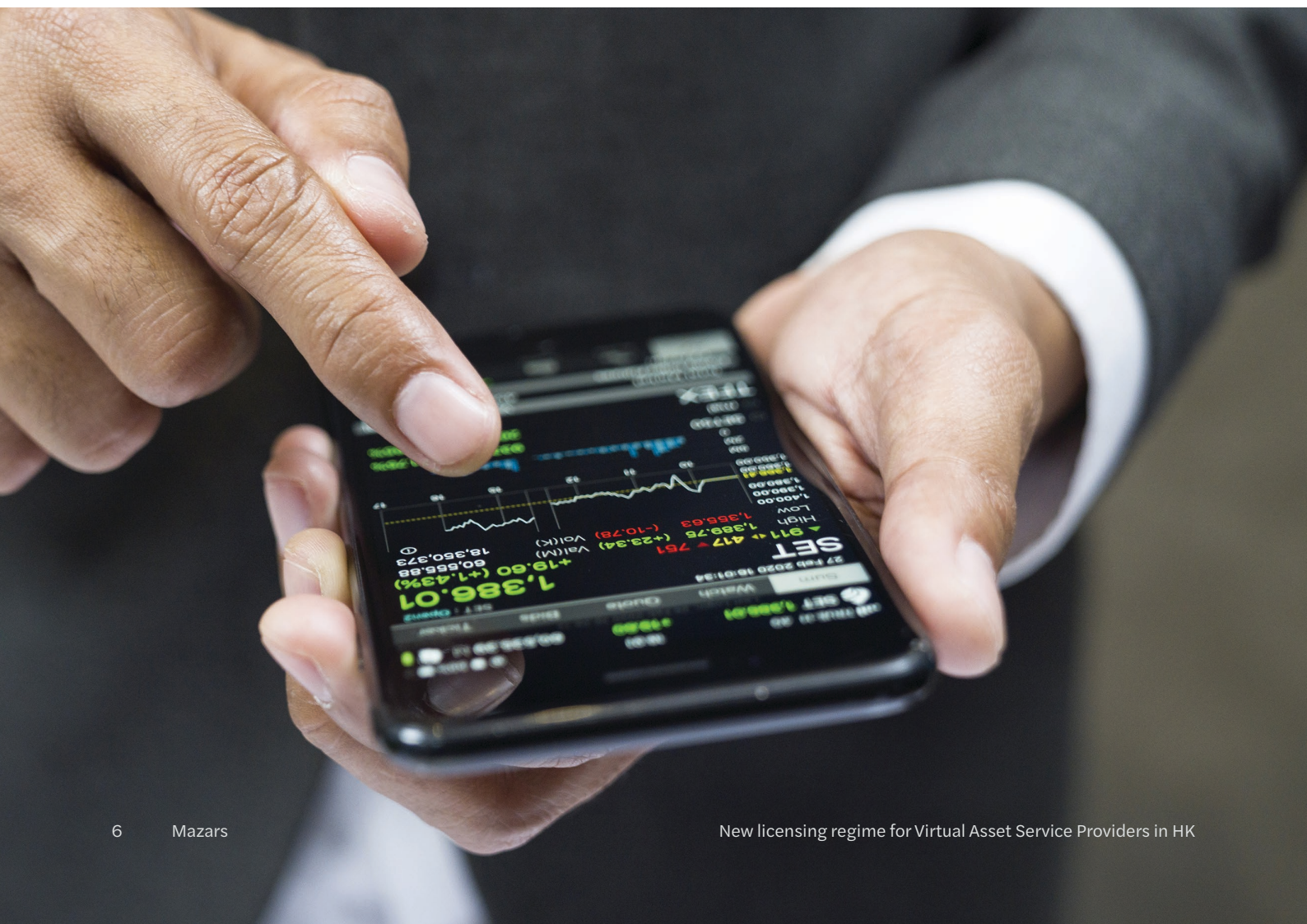
To ensure the SFC's effectiveness to supervise the operation of its VASP licensees, only (i) companies incorporated in Hong Kong with a permanent place of business within the territory, and (ii) companies incorporated outside Hong Kong but registered in Hong Kong under the Companies Ordinance (Chapter 622) is to be considered as eligible for a VASP licence. In other words, natural persons or business establishments without a legal personality (e.g. sole proprietors or partnerships), or companies incorporated outside Hong Kong and not registered in Hong Kong, will not be eligible for the licence.

Personnel requirements

As proposed by the FSTB, the SFC will be the licensing authority. Similar to other licensed corporations, VASP licensees will be required to appoint at least two responsible officers ("RO") who are responsible for the oversight of the VASP's operation and compliance with AML/CFT and other regulatory requirements. In case of non-compliance, the ROs are to be held personally accountable.

Apart from ROs, VASPs will also be required to appoint individuals who are licensed by the SFC to be licensed representatives in order to carry out regulated functions on behalf of the VASP. Both ROs and licensed representatives will be required to satisfy a fit and proper test and approved by the SFC.

All VASPs should note that being a licensed representative of a VASP is also a pre-requisite for an individual to be approved as a responsible officer of the VASP and that only responsible officers approved by the SFC in relation to a VASP may become executive directors of the VASP.



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4. Ongoing regulatory requirements

Professional investor requirement

As the FSTB proposed, the licensees may only offer services to **professional investors** at the initial stage. The professional investor requirement will be imposed as a regulatory requirement made by the SFC with the power given in the AMLO.

Other regulatory requirements

The licensed VASP will abide by a set of regulatory requirements to be imposed as licensing conditions by the SFC. The requirements will cover a wide range of matters including financial resources, risk management policies and procedures, anti-money laundering and anti-terrorist financing policies and procedures, management of client assets, virtual asset listing and trading policies and so on.

While the amended AMLO does not specify the details of the above regulatory requirements, the SFC will prepare for the implementation of the new regimes including, inter alia, the preparation of rules and guidelines before the commencement of the Amendment Bill. Before more details are revealed prospective applicants may at this stage make reference to the key areas below from the Licensing Terms and Conditions for Virtual Asset Trading Platform Operators issued by the SFC under the 2019 framework.

(a) Financial resources

A Platform Operator should maintain in Hong Kong at all times own assets that are sufficiently liquid equivalent to at least 12 months of its actual operating expenses calculated on a rolling basis.

(b) Risk management policies and procedures

A Platform Operator should have a sound risk management framework which enables them to identify, measure, monitor and manage the full range of risks arising from their businesses and operations.

A Platform Operator should put in place risk management and supervisory controls for the operation of its trading platform. These controls should include automated pre-trade controls and post-trade monitoring.

(c) Anti-money Laundering and Anti-terrorist Financing policies and procedures

The SFC expects a platform operator to establish and implement adequate and appropriate AML/CFT policies, procedures and controls. A platform operator should also regularly review the effectiveness of its AML/CFT systems and introduce enhancements where appropriate.

(d) Management of client assets

A platform operator should establish and implement policies on handling of client virtual assets and client money. It should assign designated staff member(s) to conduct regular internal audits to monitor its compliance with the requirements for custody of client assets, and its established policies and procedures in respect of handling of these assets. In respect of the custody of client virtual assets, a Platform Operator should ensure that an insurance policy covering risks associated with the client virtual assets held in hot storage (full coverage) and risks associated with the client virtual assets held in cold storage (a substantial coverage, for instance, 95%) is in effect at all times.



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(e) Virtual Asset listing and trading policies

A platform operator should set up a function responsible for establishing, implementing and enforcing the following:

- i. the rules which set out the obligations of and restrictions on virtual asset issuers;
- ii. the criteria for a virtual asset to be included on its platform and the application procedures; and
- iii. the criteria for halting, suspending and withdrawing a virtual asset from trading on its platform, the options available to clients holding that virtual asset and any notification periods.

A platform operator should also perform all reasonable due diligence on all virtual assets before including them on its platform for trading, and ensure that they continue to satisfy all application criteria.

(f) Others

In addition to the key regulatory areas stated above, the followings are other areas on which the SFC would impose regulatory requirements:

- i. knowledge and experience of VASP licence applicant;
- ii. financial reporting and disclosures;
- iii. soundness of the business;
- iv. prevention of market manipulation and abusive activities;
- v. avoidance of conflicts of interest;
- vi. keeping of accounts and records by licensed providers and their associated entities;
- vii. provision of contract notes, receipts, statements of account and notifications by licensed providers and their associated entities;
- viii. financial statements and other documents, and the auditor's report;
- ix. business conduct of licensed providers and their licensed representatives;
- x. notification of changes; and
- xi. cybersecurity.

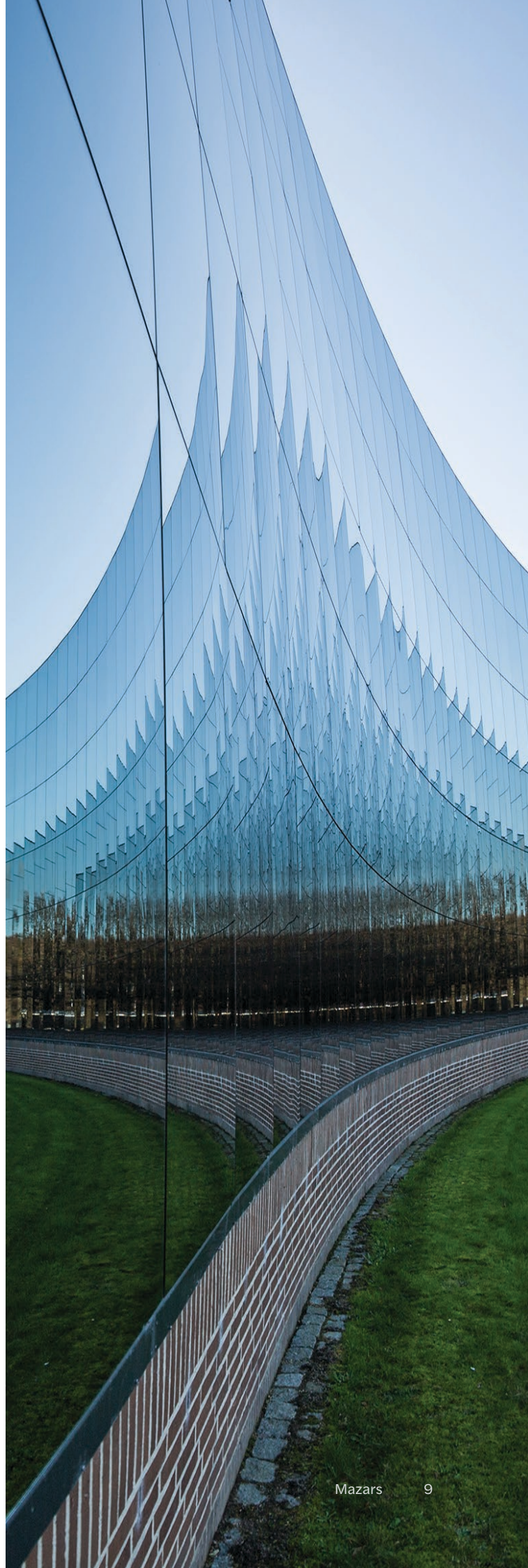
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5. Implementation timeline

The part and provisions of the Amended AMLO relating to the new VASP regime will take effect from 1 March 2023. Corporations which have been carrying on a business of providing the VA Service in Hong Kong immediately before 1 March 2023 will be given 12 months as the transitional period to continue their pre-existing service.

After the transitional period, the above-mentioned corporations are required to make an application for the proposed VASP license confirming:

- a. that they have been providing VA service in Hong Kong immediately before 1 March 2023;
- b. that they will comply with the regulatory requirements; and
- c. that they have arrangements in place to ensure they comply with the regulatory requirements applicable to a licensed provider of the VA service, within the first 9 months after the proposed licensing regime takes effect.





How can Mazars help?

At Mazars, we have extensive experience working with the diversity of financial services players. We assist major financial institutions including brokerage houses, asset managers, investment and corporate banks, retail and private banks, central banks, insurance companies and regulators in dealing with business and regulatory issues with impacts, domestic and international.

Mazars is here to assist you in complying with the regulatory standards and requirements in making a timely application for a VASP licence. Depending on the scope, coverage and specifics of your needs, our services would typically involve one or more of the following:

How can Mazars help?

A. Assistance/advice on VASP licensing requirements

- I. Initiate a preliminary consultation on VASP licence:
 - Provide advice to management on the regulatory approval process
 - Assist in identifying and capturing regulatory issues / hurdles that may arise during the application process
 - Advise on the key areas considered by the SFC in granting the licence (e.g. governance and control arrangements, proposed business activities, financial projections, risk management controls, etc.)
 - Assist in the initial discussion with the SFC
 - Advise on practical questions during the application process
- II. Review / provide compilation advice for submission to the SFC (including the tailoring of documentation which is currently available with your institution to a standard acceptable by the regulators):
 - Review and provide compilation advice on business plan
 - Review and provide compilation advice on financial projection and pro-forma liquid capital calculation
 - Review and provide advice on organisation chart and staff plan (including qualification of RO candidates) against regulatory expectations
 - Review and provide advice on internal control systems against planned business operation and industry good practice e.g. risk management policy, anti-money laundering guideline, structure of management committees and their respective authorities, etc.
 - Review and provide advice on the overall consistency of the application documents and drafting of cover letter
- III. Provide assistance and advice in responding to further information requests from the SFC:
 - Accompany management to meetings with the SFC to address any issues and concerns arising during the approval process
- IV. Perform project management during the application process:
 - Set-up of project governance framework, structure and reporting arrangements
 - Design of project plan including milestones and working committee involvement
 - Ensure timely delivery of pre-determined targets
 - Tracking of application status with regulators

B. Design and implementation of policies and procedures

- I. Review documentation and records with a focus on the in-scope activities to ensure compliance, and
- II. Provide advice in designing and implementing enhancements to the risk management / compliance manual, in order to comply with the relevant requirements.

C. Training and insights

- I. Provide training and education for staff, the board and senior management on the legal and regulatory framework on the new VASP regime.
- II. Provide ongoing insights into how peer firms are dealing with the regulatory changes and any common challenges encountered along the way.

We also take on special projects and ad-hoc mandates. We are flexible in our approach and offerings. Please feel free to contact us with any enquiries.

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