



SFC licensing regime for virtual asset trading platform operators in Hong Kong

The "Consultation Conclusions on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators (VATPOs) Licensed by the Securities and Futures Commission (SFC)" outlines new regulatory requirements for VATPOs in Hong Kong. The new regulations are designed to increase investor protection and reduce the risk of money laundering and terrorist financing in the Virtual Asset (VA) market.

Under the new regulations, VATPOs must obtain a license from the SFC and meet a range of requirements related to risk management, investor protection, and financial reporting, among others. These requirements include maintaining adequate capital reserves, implementing comprehensive security and risk management systems, and ensuring that client assets are kept separate from company assets.

The regulations also require VATPOs to implement measures to prevent market manipulation, such as monitoring suspicious trading patterns and enforcing trading restrictions on insiders. In addition, platform operators must comply with anti-money laundering and counter-terrorist financing requirements and report suspicious transactions to the relevant authorities.

This publication offers an overview of the key components of the newly established VATPOs licensing regime and delineates how our financial consulting services can assist in preparing for this new and imminent regulatory requirement.

Allow retail access to certain VAs on licensed VATPOs

SFC allows licensed VATPOs to provide their services to **retail investors** and give these investors **access to trading services offered**, provided that the VATPOs must comply with a number of **strict regulatory and investor protection** measures, such as the listed below:

- a. Licensing requirements
- b. Cybersecurity & compensation arrangement
- c. Token admission and AMLO compliance
- d. Regulatory governance & disclosure obligations

Licensing requirement & timeline

Licensing requirements

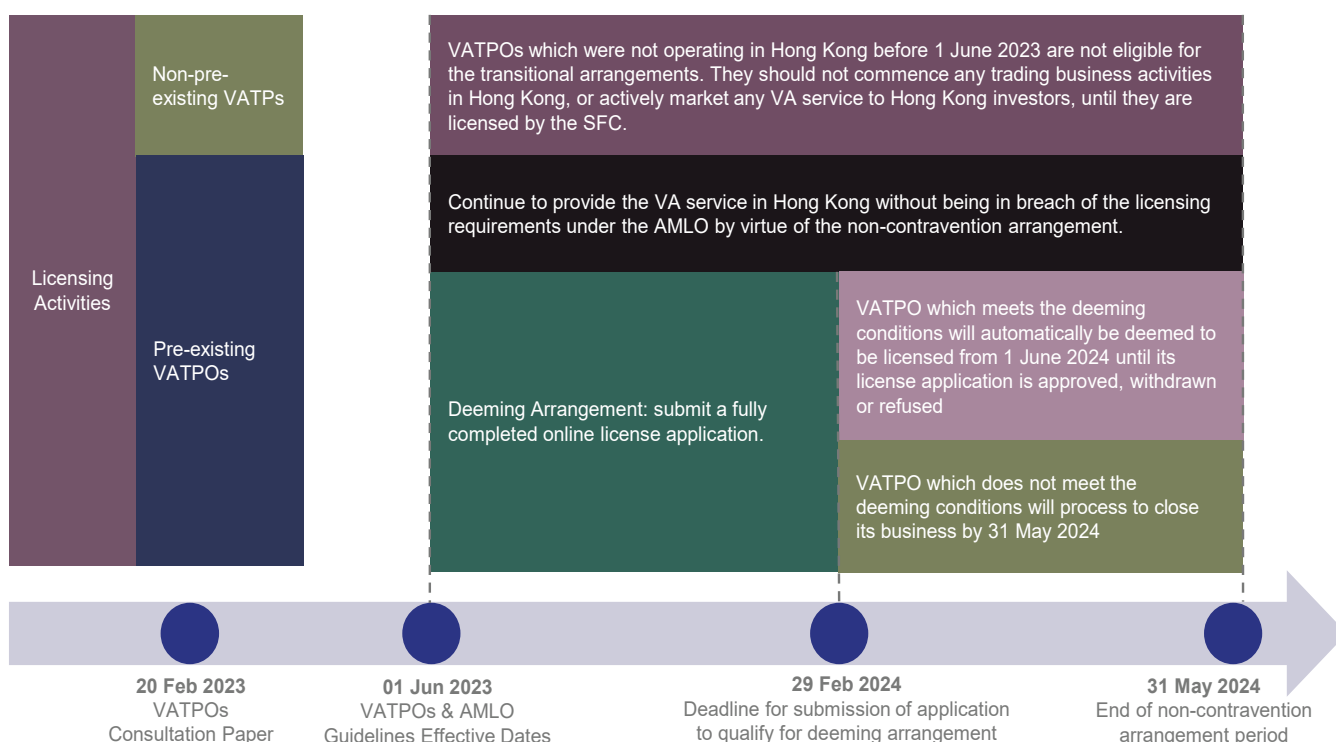
A VATPO should establish policies and procedures to ensure the integrity, security, availability, reliability and completeness of all information.

i. Reporting requirements

- a. VA entities are obligated to engage external assessors who are independent and qualified in the field, to conduct thorough **evaluations of their operations, systems, controls, and compliance measures** in relation to **SFC's External Assessment Report (EAR)*** requirements
 1. First-Phase Assessment: an EAR on **design effectiveness** with its license application
 2. Second-Phase Assessment: an EAR on **implementation of systems and controls after an approval in principle has been granted**
- b. In addition, an EAR mandates that VA entities, such as exchanges or platforms, undergo **regular assessments** conducted by an external assessor

ii. Financial resources and capital requirements

- Always maintain all assets in Hong Kong
- Sufficiently liquid (but not virtual asset) equivalent calculated on a rolling basis, to **at least 12 months of its actual operating expenses**
- Maintain minimum paid-up **share capital of not less than HK\$ 5,000,000 at all times**



* An External Assessment Report refers to a detailed assessment and evaluation report prepared by an independent third-party assessor. This report is a crucial requirement for applicants seeking a license to operate a virtual asset trading platform in Hong Kong. The EAR requires each VATPO applicant under the existing SFO regime and/or the AMLO Virtual Asset Service Provider regime to submit (i) an external assessor report when submitting its licence application, and (ii) another external assessor report after an approval-in-principle has been granted.

Cybersecurity & compensation arrangement

VATPOs are required to implement robust risk management systems, including cybersecurity measures. The SFC stipulates that **98%** of client virtual assets must be stored in **cold storage**, thereby ensuring safe custody of client assets.

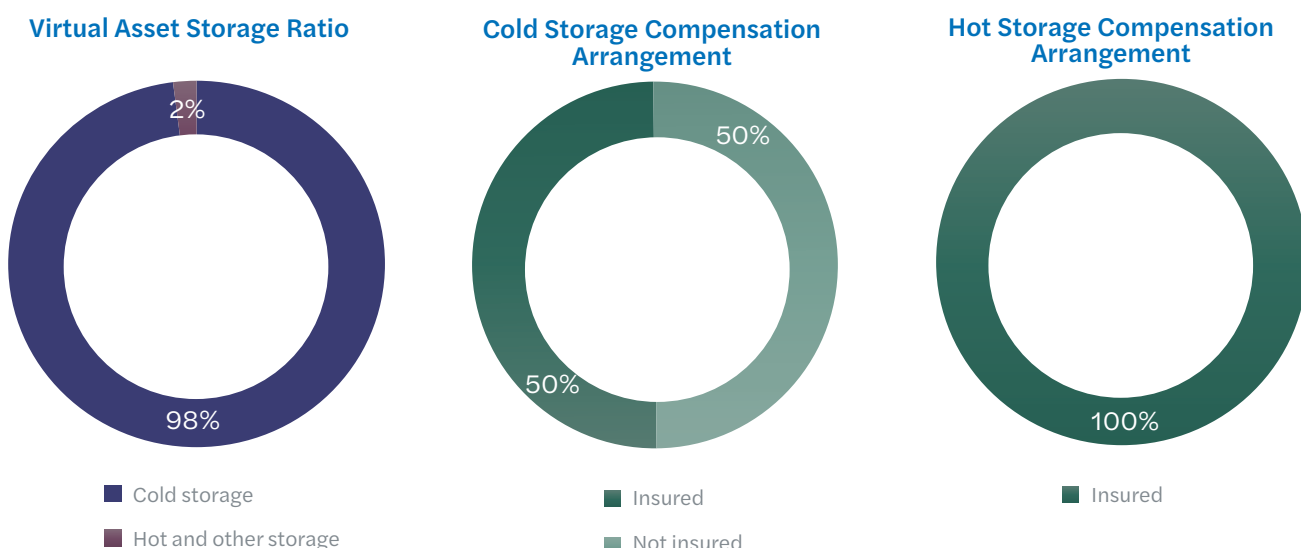
I. Key Cyber Security controls for VATPOs

Cryptographic Seeds and Private Key Control:

- Access control to guarantee that all cryptographic seeds and private keys are generated, maintained, and backed up in a safe manner
- Platform operators should set up and put into place robust internal controls and governance procedures for private key management
- Seeds and private keys should be securely stored in Hong Kong

II. Compensation /Insurance arrangement

- **VAs Cold to Hot Storage ratio: 98%** of client VAs must be stored in cold storage and only 2% stored in hot or other storages
- A VATPO should have in place a **compensation arrangement** approved by the SFC to **cover the potential loss of 50% of client virtual assets** in cold storage and **100% of client virtual assets** in hot and other storages
- The arrangement should include any or a combination of the options below:
 - a. **third-party insurance**
 - b. **funds or virtual assets** of the Platform Operator or any corporation within the same group of companies as the Platform Operator which are set aside on trust and designated for such a purpose
 - c. **bank guarantee** provided by an authorized financial institution in Hong Kong



Token admission and AMLO compliance

I. Token admission criteria and token due diligence

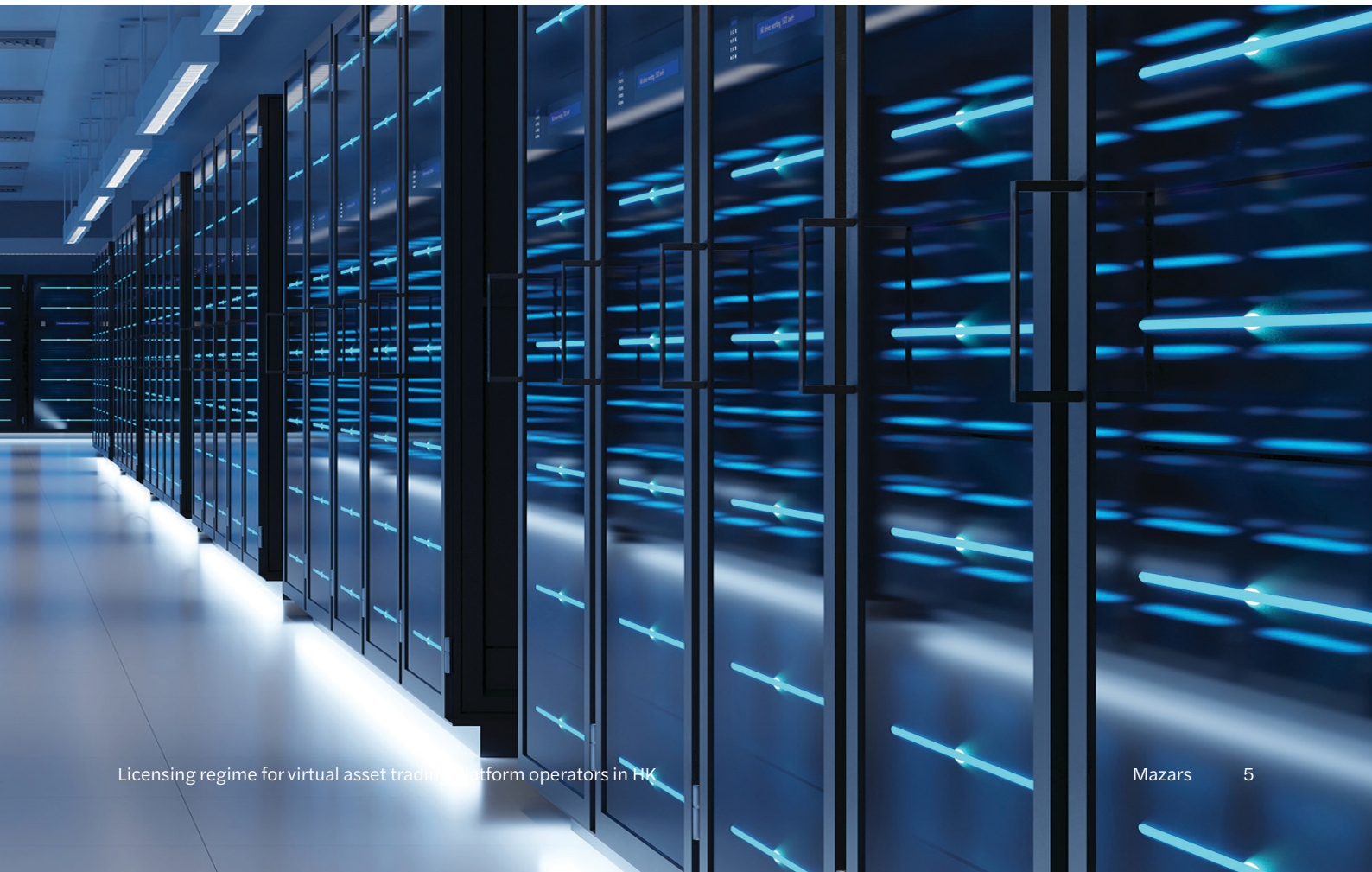
VATPOs must verify and conduct **due diligence on each token** before admission for trading. The following measures are applicable :

- a. **token due diligence:** include an assessment of the issuer's business model, the token's purpose, rights, and features, and its legal and regulatory status
- b. **evaluate** the token's technology, including its underlying **blockchain or distributed ledger** technology
- c. **high token's liquidity** and included in two acceptable indices as a minimum criterion
- d. assess the **token's market integrity** and **potential for market manipulation**
- e. SFC does not deem it appropriate to provide any exemption from conducting due diligence such as for a token that has been admitted on another licensed VA trading platform

II. Compliance with Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) regulations

The key AML /CFT measures for VATPOs include, but not limited to

- a. **Travel Rule:**
 - i. VATPOs must collect and share originator and recipient information securely when acting as the ordering institution
 - ii. When acting as the beneficiary institution, they must obtain and retain information from the ordering institution
- b. **Counterparty Due Diligence:** VATPOs should assess the risk of their VA transfer counterparties based on factors like the products /services offered and customer profiles



Regulatory governance & disclosure obligations

I. Market surveillance to prevent market manipulation and other misconduct

A VATPO should 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 its trading platform

For instance, a VATPO should set out illustrative indicators of suspicious trading including wash trading. Wash trading refers to the entry of matching buy and sell orders in particular virtual assets, which create the illusion of active trading with no change in the beneficial ownership of the virtual assets. Such wash trading does not result in a bona fide market position, which might also provide “cover” for a money launderer

In addition, a VATPO should:

- a. Review the effectiveness of the market surveillance system provided by the independent provider on a regular basis, at least annually
- b. Make enhancements as soon as practicable to ensure that market manipulative or abusive activities are properly identified
- c. The review report should be submitted to the SFC upon request

II. Protection of investors and client assets

A VATPO should minimize the risk of errors, fraud, or non-compliance, thereby fostering **trust, transparency, and accountability** in the management of client assets

- **Internal procedures:** Established for handling deposits and withdrawals of client assets in these accounts
- **Regular internal audits:** Designated staff to monitor compliance with client asset custody requirements and policies

III. Disclosure of information to clients

A VATPO should ensure that clients have a full understanding of the **costs, risks, and features of the virtual asset trading services** offered by the platform

- **Disclosure of information:** A VATPO must provide clear and comprehensive information to clients, including details about **fees, risks associated with virtual asset trading, and platform features**

IV. Business conduct rules and ethical standards for platform operators

A VATPO should ensure that client interests are given priority over their own, including **fair treatment of clients**, avoiding **conflicts of interest**, and ensuring proper management and control of client assets

- **Business Conduct Rules:** A VATPO must adhere to specific business conduct rules when providing virtual asset trading services
- **Ethical Standards:** Platform operators are expected to maintain high ethical standards in their operations

How can Mazars help?

Phase 1: Assistance /advice on VATPOs licensing requirements

- I. Provide preliminary consultation on VATPOs license
- II. Provide external assessment services for VATPOs license application
- III. Provide /review compilation advice for submission to SFC
- IV. Assist and advice in response to further information requests from SFC
- V. Perform project management during the application process

Phase 2: Design and /or implementation of control measures

- I. Review documentation and records on in-scope activities to ensure compliance,
- II. Design and /or implement enhancements to the risk management /compliance measures
- III. Provide ongoing insights and consultation dealing with regulatory requirements /changes and any challenges encountered along the way.

Mazars assists 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 VATPOs license.



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