

立法會
Legislative Council

LC Paper No. CB(1)1070/2024(02)

Ref: CB1/HS/1/23

**Subcommittee on Issues Relating to the Development of Web3
and Virtual Assets**

**Background brief on development and regulation of
virtual assets in Hong Kong**

Purpose

This paper provides background information on the development and regulation of virtual assets (“VAs”) in Hong Kong. It also summarizes the major views and concerns expressed by Members during relevant discussion of the Panel on Financial Affairs (“the Panel”) in recent years, and the Bills Committee on Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 (“the Bills Committee”).

Background

2. In October 2022, the Government issued a Policy Statement on Development of Virtual Assets in Hong Kong (“the Policy Statement”), setting out the vision and policy direction of the Government to develop a vibrant sector and ecosystem for VAs. The Policy Statement sets out the Government’s plans to put in place both appropriate regulation as well as market development initiatives, with a view to facilitating the sustainable and responsible development of the sector. In respect of regulation, the Government and financial regulators will adopt the principle of “same activity, same risks, same regulation” to put in place necessary guardrails to address the risks associated with VAs, including actual and potential ones on financial stability, money laundering/terrorist financing (“ML/TF”), and investor protection.

The licensing regime under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance

3. To address ML/TF risks of VA activities and respond to the Financial Action Task Force¹ (“FATF”)’s requirement since February 2019 for jurisdictions to

¹ FATF is an inter-governmental body setting standards on combating ML/TF through the making of recommendations for compliance by member jurisdictions (including Hong Kong).

regulate VA services providers (“VASPs”) and supervise their compliance on anti-money laundering and counter-terrorist financing (“AML/CTF”) measures, the Administration introduced the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 into the Legislative Council (“LegCo”) in July 2022, which was enacted as the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Ordinance 2022 (“the Amendment Ordinance 2022”) in December 2022, to provide for a licensing regime for VASPs under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (“AMLO”) (“the AMLO licensing regime”). With the commencement of the AMLO licensing regime, any person engaging in VA trading platform (“VATP”) business (“VA service”)² in Hong Kong or actively marketing their VA services to Hong Kong investors is required to be licensed by the Securities and Futures Commission (“SFC”).³ The AMLO licensing regime has commenced operation since 1 June 2023.

4. The Amendment Ordinance 2022 also provides for the transitional arrangements of the AMLO licensing regime. VATPs which had been providing a VA service in Hong Kong before 1 June 2023 (“pre-existing VATPs”) may continue to provide the VA service in Hong Kong from 1 June 2023 to 31 May 2024 (i.e. within the first 12 months from 1 June 2023), and would not be considered as contravening the relevant licensing requirements under AMLO. Operators of pre-existing VATPs who are prepared to comply with SFC’s standards are required to submit an application to SFC within the first nine months from 1 June 2023 (i.e. between 1 June 2023 to 29 February 2024). The pre-existing VATPs can be deemed to be licensed from 1 June 2024 to conduct a business of providing a VA service pending the final determination of its licence application if several deeming conditions are met. Those who do not plan to apply for a licence should proceed to an orderly closure.

² Specifically, this refers to operating a VA exchange, this is to say, providing services through means of electronic facilities —

(a) whereby —

(i) offers to sell or purchase VAs 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 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

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

³ Under section 53ZRD of AMLO, any person who carries on a business of providing a VA service, or holds itself, himself or herself out as carrying on such a business, is required to apply for a licence from SFC. Under section 53ZRB of AMLO, any person who actively markets to the public any services that the person provides and which would constitute a VA service if provided in Hong Kong, is regarded as providing a VA service. For VATPs intending to provide trading services in security tokens, they will require a licence for Types 1 and 7 regulated activities under the Securities and Futures Ordinance (Cap. 571).

5. In May 2023, SFC announced the relevant regulatory requirements in relation to VATPs, including proper asset custody, preventing conflicts of interest, cybersecurity, accounting and auditing, risk management, AML/CTF, etc. SFC also requires licensed VATPs to put in place appropriate investor protection measures for retail investors of VAs, including ensuring suitability of clients when establishing business relationship.

Proposed regulation of over-the-counter trading of virtual assets

6. In 2023, a number of fraud cases associated with alleged VATPs have triggered widespread public concerns over the risks of VA activities, in particular those involving VA OTC shops. The Administration sees a need to regulate under AMLO certain VA OTC services, which, according to the Administration, have served as one of the main avenues for channeling retail investors' funds to the suspected fraudulent schemes. A public consultation on the legislative proposals to introduce a licensing regime for providers of VA OTC trading services was conducted from 8 February 2024 to 12 April 2024. The salient points of the legislative proposals are as follows:

- (a) requiring any person who conducts a business in providing services of spot trade of any VA for money in Hong Kong to be licensed by the Commissioner of Customs and Excise ("CCE");
- (b) covering all VA OTC services irrespective of whether the services are provided through a physical outlet and/or other platforms;
- (c) providing powers for CCE to supervise the AML/CTF conduct of licensees, and enforce the statutory and regulatory requirements under the proposed regime; and
- (d) providing transitional arrangement to facilitate the effective implementation of the regulatory regime.

7. According to the Administration, under the proposed licensing regime for VA OTC services, licensees will be allowed to perform spot trade of any VA for any money, or vice versa, but not VA-to-VA trading services. Provision of such services will require a VATP licence.

Proposed regulatory regime for stablecoin issuers

8. The Financial Services and the Treasury Bureau and the Hong Kong Monetary Authority ("HKMA") jointly issued on 27 December 2023 a [public consultation paper](#) on the legislative proposal to implement the regulatory regime

for stablecoin⁴ issuers. In view of the important roles played by stablecoins in the Web3 and VA ecosystem, and the rising interconnectedness between the traditional financial system and the VA markets, the Administration considers that a regulatory regime should be introduced for fiat-referenced stablecoin (“FRS”) issuers. Bringing FRS issuers into the regulatory remit under a risk-based and agile approach will facilitate a proper management of the potential monetary and financial stability risks, and provide transparent and suitable guardrails with the increased prevalence of VAs.

9. According to the Administration, the legislative proposal has taken into account the feedback received from the market and the public to “[Discussion Paper on Crypto-assets and Stablecoins](#)” issued by HKMA in January 2022, the ongoing engagement exercises with stakeholders, local market conditions and needs, and applicable international standards. Its salient features are as follows:

- (a) introducing a new piece of legislation to implement a licensing regime requiring all FRS issuers that meet certain conditions⁵ to be licensed by the Monetary Authority (“MA”);
- (b) requiring that FRS can only be offered by specified licensed entities⁶, and only FRS licensed by MA can be offered to retail investors;
- (c) prohibiting the advertising of (i) FRS issuance by unlicensed entities or (ii) non-specified licensed entities’ offering of FRS;
- (d) providing the necessary powers for the authorities to adjust the parameters of in-scope stablecoins and activities having regard to the rapid VA market development; and
- (e) providing a transitional arrangement to facilitate the implementation of the regulatory regime.

The consultation period ended on 29 February 2024. The Administration and HKMA would further refine the framework of the proposed regulatory regime for stablecoin issuers after considering the views gathered during consultation.

⁴ Stablecoins are VAs that are designed to maintain a stable value relative to certain assets, typically currencies.

⁵ This refers to FRS issuers who (i) issue an FRS in Hong Kong; (ii) issue a Hong Kong dollar-referenced stablecoin; or (iii) actively market their issuance of FRS to the public of Hong Kong.

⁶ These refer to licensed FRS issuers, authorized institutions, licensed corporations and licensed VA trading platforms.

Views and concerns expressed by Members

10. The major views and concerns expressed by Members on issues relating to the development and regulation of VAs at the Panel meetings in recent years and during the discussion of the Bills Committee are summarized in the ensuing paragraphs.

Regulation of virtual asset services providers

Rationale for tailoring the licensing regime for virtual asset exchanges

11. During discussion of the Administration's proposal to introduce a regulatory regime for VASPs at the Panel meeting on 7 February 2022, Members were concerned that the proposed regulatory regime only covered the carrying on of a business of operating a VA exchange but not other forms of VA business such as VA OTC trading, peer-to-peer VA trading, stand-alone VA payment or custodian system.

12. The Administration explained that the regulatory regime for VASPs was developed on the basis of the prevailing international standards for addressing ML/TF risks of VA activities and ensuring proper protection of market integrity and investor interests. The AMLO licensing regime was tailored for VA exchanges as they were by far the most prevalent and developed embodiment seen in Hong Kong. Besides, VA activities conducted outside VA exchanges either had scanty local presence (e.g. VA payment systems) or could involve financial institutions which were already subject to the regulation of AMLO. Like any other legal and natural persons in Hong Kong, persons carrying on such business were also subject to the obligations of reporting suspicious transactions and implementing targeted financial sanctions promulgated by the United Nations Security Council. Nevertheless, the Administration undertook to keep in view the development in the VA market, the situation in Hong Kong and the implementation of the regulatory regime, and consider the need for regulating other forms of VA business.

Regulation on the promotion, marketing and sales practices of virtual assets

13. Pointing out that currently non-SFC licensees, including some online key opinion leaders, might promote VAs to retail investors without conducting due diligence on customers and products, Members expressed concern on possible regulatory loopholes with regard to promotion, marketing and sales practices of VAs. In this regard, Members made the following suggestions:

- (a) to step up regulation on persons who were engaged in introducing and selling VA services or products to the public, including the

requirements for them to undergo training and continuing education, assume self-responsibility, disclose remuneration, obtain licences, declare whether they were licensees, and/or even enacting legislation to directly prohibit them from marketing and selling such services and products to retail investors;

- (b) to make greater efforts calling on investors to seek investment advice only from licensed companies and licensed persons and pay attention to the risks involved in obtaining such advice from non-licensed persons;
- (c) to increase the penalty imposed on persons who falsely claimed themselves to be licensed persons; and
- (d) to monitor the content of online platforms so as to proactively identify and warn the public of financial fraud messages. In addition, some Members considered that the responsibility to be assumed by platforms for publishing VA advertisements should be clarified.

14. The Administration responded that all along, SFC had not only monitored VA activities in Hong Kong, but also investigated and regulated suspicious activities within its regulatory ambit. SFC collected information through a wide range of channels, and maintained regular and close communication and cooperation with responsible departments and agencies. Under the current licensing regime, it would be an offence for any person to operate a VA exchange in Hong Kong or to engage in the marketing of VA services to the public of Hong Kong without a licence, and SFC was vested with a range of statutory powers and tools to combat fraudulent or deceptive behaviour in any transaction involving VAs, as well as behaviour involving the use of fraudulent or reckless means (e.g. issuing untrue and misleading information or advertisements) to induce others to invest in VAs.

15. The Administration further explained that at present, any person advising the public on a specific security on platforms such as newspapers, radio programmes and the Internet was generally not required to obtain a licence if he did not receive income in this regard from companies relating to that security. Hence, Members' suggestion of requiring key opinion leaders to hold a licence before they could recommend VA services or products to the public (regardless of whether they received an income in this connection from the companies concerned) might not be in line with the current regulations and measures, and the Administration would need to study the suggestion in detail. Besides, SFC had already stepped up publicity to encourage investors to proactively verify, by visiting SFC's website, the identity of those claiming to be licensed institutions or practitioners. .

Investor protection

16. Members asked how investors would be protected from fraud involving VAs, including whether there was any ring-fencing arrangement on a licensed VA exchange to protect the assets of its clients.

17. SFC advised that a licensee would be required to purchase insurance for its clients' assets and make proper arrangements in relation to the assets. All relevant investor protection measures currently applicable to SFC-regulated intermediaries (like proper segregation of client assets and financial resources requirements) would also be adopted in the current AMLO licensing regime.

Regulation of over-the-counter trading of virtual assets

18. Members enquired whether the Administration had a full picture of the size and mode of operation of the VA OTC market in Hong Kong, including the number of purported VA OTC operators engaging in fraudulent activities under the guise of OTC trading. Members suggested that the Customs and Excise Department ("C&ED"), as the regulatory authority for the proposed licensing regime, and SFC set up a task force to maintain close liaison, with a view to enabling more comprehensive regulation of service providers of VA OTC trading; and considered that the dedicated inter-departmental working group established by SFC and the Hong Kong Police Force should exchange information on complaints and intelligence pertinent to VA trading platforms or suspicious VA-related activities on a daily basis, thus further protecting members of the public against frauds.

19. The Administration advised that C&ED had set up a task force to conduct internal assessment, meet with members of the industry and consult LegCo Members to get a grasp on the current size and mode of operation of the VA OTC market, including its various sub-sectors. The Administration would study the information and views collected during the consultation period for establishing the most effective regulatory regime, and would enhance communication and liaison with SFC and HKMA in addressing regulatory issues after the commencement of the regulatory regime.

20. Members enquired whether the Administration would consider only allowing professional investors to trade in VAs through licensed OTC service providers, or at least imposing such a restriction at the initial stage of the operation of the regulatory regime to protect retail investors who might not be aware of the risks involved. The Administration responded that the proposed licensing regime would only allow licensed OTC operators to provide some pre-vetted VA services to retail investors. It would also enhance investor education to help them better understand the features and investment risks of various VAs.

21. In response to Members' enquiry about cross-border cooperation in regulating OTC service providers from outside Hong Kong who provided services or conducted marketing to the Hong Kong public in digital form, the Administration advised that under the proposed licensing regime, any person operating a VA OTC business in Hong Kong, or actively marketing the provision of VA OTC services to the Hong Kong public, was required to obtain a licence issued by the CCE. Various factors had been taken account of in designing the regulatory regime, including cross-border regulation. A study was being conducted on non-local VA OTC service providers marketing their business to the Hong Kong public online (e.g. through social media). Consideration would be given to strengthening the regulatory requirements under the licensing regime in relation to, among others, the establishment of a business relationship with customers, and the identification of their customers. Consideration would also be given to empowering the authorities to block allegedly fraudulent websites.

Proposed regulatory regime for stablecoin issuers

22. Members noted the redemption requirements under the proposed regulatory regime for stablecoin issuers, including the processing of relevant requests without undue costs or unreasonable conditions on a timely basis, and enquired about the meaning of "due costs" and "on a timely basis". In addition, Members enquired whether, since the launch of the stablecoin sandbox arrangement by HKMA in March 2024, any institution had applied for joining the arrangement or expressed interest in issuing stablecoins.

23. HKMA advised that upon the implementation of the regulatory regime for stablecoin issuers, specific guidelines in respect of the redemption requirements would be issued to define "due costs" and "on a timely basis". Regarding the sandbox arrangement, HKMA advised that the purpose of the stablecoin sandbox arrangement was to allow institutions having a genuine interest in and a reasonable plan on issuing stablecoin in Hong Kong to test, in a risk-controlled environment, the feasibility of their stablecoin issuance processes, business models, as well as investor protection and relevant risk management arrangements, and to have bilateral communications with HKMA directly on the regulatory requirements to be implemented in future. At present, a number of operators interested in issuing stablecoin in Hong Kong were already in discussion with HKMA.

24. Members noted that under the proposed regulatory regime for stablecoin issuers, the stablecoin issuer must ensure that the value of the reserve assets backing an FRS was not lower than the par value of the FRS in circulation at all times. Members suggested that the requirement be suitably relaxed to facilitate the development of the stablecoin market.

25. HKMA explained that as each stablecoin represented the value of a particular fiat currency, corresponding reserve assets were fundamentally required to guarantee that the value of a stablecoin could be traced back to the value of the underlying fiat currency. Relevant international standards also emphasized that reserve assets must cover at least 100% of the issue value. Regarding the financial resources requirements, the current proposal was to adopt 2% of the par value of FRS in circulation as one of the benchmarks for calculating the capital requirement, so as to ensure that stablecoin issuers had sufficient resources to guarantee the overall soundness of their operations. In the public consultation concluded on 29 February 2024, HKMA also received market views on the financial resources requirements. HKMA would consolidate those views and take into account international best practices before finalizing the financial resources requirements.

26. Members expressed concern about whether there were sufficient talents in Hong Kong to conduct risk management for the proposed regulatory regime for stablecoin issuers. The Administration responded that Hong Kong had a sufficient supply of professionals for asset management and custody, anti-money laundering and auditing work required for the implementation of the regulatory regime. Moreover, financial services and innovation and technology were under the industry segments on the Talent List of Hong Kong, and fintech talents admitted to Hong Kong would include those familiar with stablecoin operation.

Relevant motion passed and questions raised at Council meetings

27. The Council passed a motion on “Comprehensively promoting the upgrading and transformation of industries to foster the diversification of financial and economic development” at the Council meeting of 10 May 2023 urging the Government to consider, inter alia, fostering the diversified development of the financial industry: to actively develop financial services areas such as securities, commodity futures, precious metals, corporate financing, funds, VAs and innovation fields; and enhancing cooperation with the Mainland Government to foster the development of fintech in the Guangdong-Hong Kong-Macao Greater Bay Area, while taking forward more early and pilot financial liberalization and innovation schemes, thereby proactively expanding the overseas markets for fintech products and services.

28. Members also raised questions relating to the development and regulation of VAs at various Council meetings. The relevant hyperlinks are in the **Appendix**.

Relevant papers

29. A list of relevant papers is set out in the **Appendix**.

Council Business Divisions
Legislative Council Secretariat
16 July 2024

**Subcommittee on Issues Relating to the Development of
Web3 and Virtual Assets**

List of relevant papers

Committee	Date of meeting	Paper
Bills Committee on Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022	25 November 2022*	Report of the Bills Committee to the House Committee
Panel on Financial Affairs	10 September 2019*	Administration's paper on Mutual Evaluation of Hong Kong's Anti-Money Laundering and Counter-Terrorist Financing Regime by Financial Action Task Force ("FATF") and Asia-Pacific Group on Money Laundering The Mutual Evaluation Report of Hong Kong, China 2019 published by FATF
	7 February 2022	Agenda Item IV: Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 Minutes
	6 June 2022	Agenda Item V: Development of financial technologies in Hong Kong and measures in tackling financial fraud Minutes
	5 June 2023	Agenda Item IV: Development of financial technologies and other innovations for financial services in Hong Kong Minutes

Committee	Date of meeting	Paper
Panel on Financial Affairs	30 October 2023	Agenda Item IV: Regulation of Virtual Asset Trading Platforms Minutes
	6 November 2023	Agenda Item III: Briefing by the Secretary for Financial Services and the Treasury on the Chief Executive’s 2023 Policy Address Minutes
	8 April 2024	Agenda Item IV: Development of financial technologies in Hong Kong and the proposed regulatory regime for stablecoin issuers Minutes

* Issue date of the papers

Council meeting	Paper
23 November 2022	Council question 1 : Promoting the development of Hong Kong into an international virtual assets centre
30 November 2022	Council question 4 : Promoting the development of the virtual assets market
8 February 2023	Council question 8 : Promoting the development of the financial investment market
10 May 2023	Members’ motion : Comprehensively promoting the upgrading and transformation of industries to foster the diversification of financial and economic development Progress report
21 February 2024	Council question 7 : Regulation of virtual asset trading
5 June 2024	Council question 9 : Promoting the development of stable coins and virtual assets