

21 January 2025
Discussion paper

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

Regulation of Virtual Asset Trading Platforms

Introduction

This paper briefs Members of the Subcommittee on the latest developments with regard to the regulation of virtual asset trading platforms (“VATPs”).

Background

2. The Government issued the Policy Statement on Development of Virtual Assets (“VA”) in Hong Kong in October 2022, setting out the commitment to enhancing the VA regulatory framework under the principle of “same activity, same risks, same regulation”.

3. In this regard, the Government has amended the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (“AMLO”) to introduce a licensing regime for VA service providers, ensuring that VATPs comply with relevant international requirements on anti-money laundering and counter-terrorist financing (“AML/CFT”) while protecting investors. The licensing regime, administered by the Securities and Futures Commission (“SFC”), has commenced operation from June 2023.

4. Under the regime, any person engaging in VATP business¹ or actively marketing such service to Hong Kong investors is required to

¹ Specifically, this refers to operating a VA exchange, this is to say, providing services through means of electronic facilities—

(a) whereby—

apply for a licence from SFC as the regulator. The applicant and relevant persons must satisfy a fit-and-proper test and comply with the AML/CTF requirements under AMLO², as well as a set of regulatory requirements on investor protection³. The regime has given SFC with supervisory, investigative and intervention powers, and provides for administrative and criminal sanctions for non-compliance cases. Apart from fulfilling international AML/CTF requirements specified by the Financial Action Task Force (“FATF”), the regime is one of the first that provides comprehensive investor protection.

5. In June 2024, 11 VATP applicants were deemed-to-be-licensed (“deemed applicants”) pursuant to Schedule 3G to the AMLO. The SFC conducted risk-based on-site inspections on all these applicants following the introduction of its inspection programme in June 2024, with a key focus on their safeguarding of client assets, know-your-client processes and cybersecurity measures.

6. As at the end of December 2024, seven VATPs were licensed under the AMLO to operate a VA exchange and the Securities and Futures Ordinance (Cap. 571) (“SFO”) for providing Type 1 (dealing in securities) and Type 7 (providing automated trading services) services⁴. There are currently 11 applications for AMLO licences as being processed by the SFC, including seven which are deemed applicants.

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- (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 virtual assets comes into direct or indirect possession of the person providing such service.

² For example, requirements on customer due diligence (“CDD”) and record keeping.

³ For example, requirements on safe and segregated custody of client assets, financial soundness and avoiding conflict of interest.

⁴ Prior to the introduction of the licensing regime under AMLO, the SFC introduced in 2018 an opt-in regime for VATPs to voluntarily come under the SFC’s regulatory remit under the SFO by trading at least one security token. With the new licensing regime, VATPs providing trading services for VAs (which exclude any security tokens) will have to be licensed under AMLO. Given that the terms and features of VAs may evolve over time and change from a non-security token to a security token (or vice versa), to avoid contravening any of the licensing regimes under SFO and AMLO and ensure business continuity, VATPs are advised to apply for approvals under both Ordinances and become dually-licensed. To ensure regulatory parity, the regulatory requirements and standards for AMLO and SFO have been aligned.

Licensing process

7. To facilitate the processing of licence applications of the deemed applicants, the SFC has adopted a swift licensing process for processing the applications of these applicants with pre-existing business in Hong Kong. In addition to a document-based vetting process, as part of its on-site inspection programme introduced in June 2024, the SFC has directly engaged and communicated with the senior management and ultimate controllers of deemed applicants. Under this approach, the SFC has been able to provide guidance effectively to VATPs on its expected regulatory standards. The SFC will maintain the effective approach of proactive engagement and enhanced communication with VATPs, through supervising the external assessment process⁵ of VATPs by becoming a party to the tripartite engagement with the VATPs and their external assessors.

8. The SFC issued a “Circular to virtual asset trading platforms on licensing process and revamped Second-phase Assessment”⁶ on 18 December 2024 to provide details on the new licensing procedures for VATPs, focusing on the requirements for the VATPs to engage external assessor(s) to assess that the VATP’s policies, procedures, systems and controls are suitably designed and implemented. In particular, the SFC requires the Second-phase Assessment to be performed as a direct assurance engagement⁷ and signed off by a certified public accountant (practising).

9. The SFC will provide additional guidance on the licensing process of new corporations applying for a licence to operate a VATP in early 2025.

⁵ Under the current licensing application process, a VATP applicant is required to submit (i) an external assessor report when submitting its licence application (“First-phase Assessment”) and (ii) another external assessor report after an approval-in-principle has been granted (“Second-phased Assessment”).

⁶ See <https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=24EC65>

⁷ Such as the Hong Kong Standard on Assurance Engagements 3000

Consultative panel for VATPs

10. In order to facilitate a sustainable business environment for the regulated VATPs in Hong Kong, and support their development of sustainable business models, the SFC will establish an official consultative panel for all licensed VATPs, which will be represented by members of their senior management in early 2025.

11. The consultative panel will ensure that the licensed VATPs' perspectives are considered in the SFC's policymaking. Further, the panel will foster a sense of community, transparency and shared responsibility amongst the participants. Based on the panel's deliberation, the SFC will develop a comprehensive roadmap for products and services, as well as potential enhancements in compliance and risk management.

Further regulatory building blocks for VAs

12. Establishing a comprehensive and robust regulatory framework for VAs is crucial for the responsible and sustainable growth of the Web3 and VA ecosystem. In this regard, the Government and regulators will continue to enhance the regulatory framework for VA activities. In particular, 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 market, the Government introduced the Stablecoins Bill into the Legislative Council on 18 December 2024 to put in place a regulatory regime for fiat-referenced stablecoin issuers to regulate them under a risk-based and agile approach⁸.

13. As regards over-the-counter trading services of VA, the Government put forward for consultation in 2024 a regulatory regime to require any person who conducts a business in providing relevant services to apply for a licence with the Commissioner of Customs and Excise, having fulfilled relevant fit-and-proper, investor protection and AML/CTF requirements. The Government's plan is to launch a second consultation in early 2025 on a refined proposal.

⁸ See Legislative Council Brief (File Reference: B&M/4/1/44C)

14. Meanwhile, the Government and financial regulators are also formulating a proposed licensing regime for VA custodian service providers, with a view to conducting a public consultation in 2025.

Next steps

15. The Government, together with financial regulators, will continue to maintain close communications on the development and implementation of various VA-related regimes, with a view to adhering to the “same activity, same risks, same regulation” principle, thereby ensuring regulatory consistency and preventing potential regulatory arbitrage. At the same time, we will also closely engage with stakeholders to ensure our measures can address financial stability needs, protect investors and promote sustainable market development.

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