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

Background brief on regulation of virtual asset trading in Hong Kong

Purpose

This paper provides background information on the regulation of virtual asset (“VA(s)”) trading in Hong Kong. It also summarizes the major views and concerns raised by Members during the discussions on the subject matter by the relevant committees of the Legislative Council (“LegCo”) in recent years.

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 in relation to the development of a vibrant sector and ecosystem for VAs in Hong Kong. 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. In line with the Policy Statement, the Administration introduced the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 into 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 the VA services providers (“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”) ¹ 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”).² 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 applications to SFC within the first nine months from 1 June 2023 (i.e. between 1 June 2023 and 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.

¹ 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.

² 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, anti-money laundering and counter-terrorist financing (“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 over-the-counter (“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 on 8 February 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.

8. The consultation period ended on 12 April 2024. The Administration is adjusting the proposal taking into account outcomes of the public consultation, and will conduct the second public consultation in 2025.

Proposed regulatory regime for stablecoin issuers

9. The Administration introduced the **Stablecoins Bill** into LegCo on 18 December 2024 to implement the regulatory regime for stablecoin issuers. According to the Administration, it is observed that stablecoins, which purport to maintain stable value relative to some real world assets (typically fiat currencies as in the case of fiat-referenced stablecoins (“FRS”)), have the potential to develop into a widely accepted means of payment and be incorporated into the mainstream financial system. Notably, FRS may pose more imminent risks as compared to other types of stablecoins, and therefore the Administration sees the need to put in place a regulatory regime for FRS issuers, where such issuers are regulated by a risk-based and agile approach.

10. The Stablecoins Bill proposes to establish a licensing regime for stablecoin issuers (“the proposed licensing regime”). The proposed licensing regime will focus on FRS by defining “specified stablecoin” which will be subject to the regulatory control of the Monetary Authority (“MA”) as a stablecoin that purports to maintain a stable value with reference wholly to one or more official currencies. Under the proposed licensing regime, no person may, without a licence granted by MA, carry on a regulated stablecoin activity which includes the issuance of a specified stablecoin in Hong Kong in the course of business. A person actively marketing the issuance of specified stablecoin to the public of Hong Kong is regarded as holding out as carrying on a regulated stablecoin activity and has to be licensed by MA. The proposed licensing criteria include the following key elements:

- (a) **Management of reserve assets and stabilization mechanism:** the market value of the reserve assets pool backing the specified stablecoins must at all times be at least equal to the par value of the outstanding specified stablecoins in circulation;
- (b) **Redemption:** a licensee must pay a specified stablecoin holder who makes a valid redemption request the par value of the specified stablecoin without imposing unduly burdensome conditions and unreasonable fees;
- (c) **Physical presence in Hong Kong:** to enable effective supervision and enforcement by MA, a licensee must have a physical presence in Hong Kong;

- (d) **Financial resources:** a licensee must have adequate financial resources for carrying on its business, including a minimum paid-up share capital of HK\$25 million;
- (e) **Fitness and properness:** controllers, chief executives and directors of a licensee must be fit and proper persons, and persons responsible for the management and operation of the regulated stablecoin activity must possess appropriate knowledge and experience; and
- (f) **Prudential and risk management:** a licensee must have in place appropriate risk management policies and procedures for managing the risks arising from the carrying on of its business that are commensurate with the scale and complexity of the operation. The licensee should also put in place adequate and appropriate systems of control for preventing and combating possible ML/TF activities.

11. Under the proposed licensing regime, only the following entities, which are regulated either by MA or SFC, can offer a specified stablecoin to the public: (a) a licensee under the proposed licensing regime; (b) a VATP licensed by SFC; (c) a corporation that is licensed by SFC for carrying on Type 1 regulated activity under section 116 of the Securities and Futures Ordinance (Cap. 571); and (d) an authorized institution as defined in the Banking Ordinance (Cap. 155).

12. A Bills Committee has been formed to study the Stablecoins Bill in detail.

Views and concerns expressed by Members

13. The major views and concerns expressed by Members on issues relating to the regulation of VA trading at the meetings of the Panel on Financial Affairs and the Subcommittee on Issues Relating to the Development of Web3 and Virtual Assets in recent years are summarized in the ensuing paragraphs.

Regulation of virtual asset services providers

Rationale for tailoring the licensing regime for virtual asset exchanges

14. During discussion of the Administration's proposal to introduce a regulatory regime for VASPs, 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.

15. 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 in future.

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

16. 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.

17. 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.

18. 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

19. 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**.

20. 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

21. 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 disguise of OTC trading. Members suggested that the Customs and Excise Department (“C&ED”), as the regulatory authority for the proposed licensing regime for VA OTC services, 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.

22. 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.

23. 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 for VA OTC services 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.

24. 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 for VA OTC services, 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

25. Members were concerned that the industry might have technical difficulties in meeting **redemption requests** under the proposed licensing regime for stablecoin issuers. The Administration responded that under the proposed licensing regime, FRS issuers must process redemption requests in a timely manner, i.e. within **one business day**, which was a practicable requirement in the Hong Kong market. In general, FRS users could cash in through well-established exchanges.

26. Members expressed concern about one of the proposed **disclosure and reporting requirements** to be imposed on stablecoin issuers which required the issuers **to engage a qualified independent auditor to conduct attestation at least once a month**, pointing out that currently, neither the Hong Kong Institute of Certified Public Accountants (“HKICPA”) nor the Accounting and Financial Reporting Council (“AFRC”) had guidelines on reporting and auditing of VAs. Members suggested that the Administration should discuss with HKICPA or AFRC to finalize the guidelines as soon as possible for reference of the accounting profession. The Administration advised that it would follow up with HKICPA on the development of the guidelines.

27. During discussion of the proposed licensing regime for stablecoin issuers, Members pointed out that under the proposed licensing regime, only FRS issued by licensees could be offered to retail investors, while FRS issued by unlicensed issuers could only be offered to professional investors. Members suggested enhancing **the protection for professional investors**.

28. The Administration advised that **the proposed licensing regime was not intended to prohibit the offering of FRS issued by unlicensed issuers**, given that FRS was in existence before the implementation of the proposed licensing regime. Intermediaries were required to assess the suitability of financial investment products for their clients when marketing the products

to them, and when offering FRS issued by unlicensed issuers, they must indicate clearly that such FRS was not a licensed FRS. The Administration stressed that given their considerable asset size and investment expertise, professional investors had to bear their own risks when investing in FRS issued by unlicensed issuers.

Relevant motion passed and questions raised at Council meetings

29. 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.

30. 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

31. A list of relevant papers is set out in the [Appendix](#).

Appendix

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	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
	30 October 2023	Agenda Item IV: Regulation of Virtual Asset Trading Platforms Minutes

Committee	Date of meeting	Paper
Panel on Financial Affairs	8 April 2024	Agenda Item IV: Development of financial technologies in Hong Kong and the proposed regulatory regime for stablecoin issuers Minutes
Subcommittee on Issues Relating to the Development of Web3 and Virtual Assets	19 July 2024	Agenda Item I: Proposed regulatory regime for stablecoin issuers Minutes

* Issue date of the paper

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 stablecoins and virtual assets
11 December 2024	Council question 15 : Policy on digital assets