

HKCGI Technology Guidance Note (Eighth Issue) - 2022 wrap up and what to expect in 2023 (Part 1) - with focus on new licensing regime for virtual asset service providers (VASPs)

Hong Kong virtual asset regulation – 2022 wrap up and what to expect in 2023 (Part 1)

Introduction

This guidance note (in two parts) aims to provide an update on the developments in virtual asset (VA) regulation in Hong Kong, including the new licensing regime for virtual asset service providers (VASPs), which will be implemented on 1 June 2023. The context is that governance professionals work as senior management of trust and company service providers (TCSPs)¹ that may operate or provide support services to VASPs. From a governance perspective, such

professionals should also keep themselves updated on developments relating to the regulation of new technology.

Statement by the Securities and Futures Commission on risks associated with VA platforms claiming to offer investment returns

On 13 December 2022, the Securities and Futures Commission (SFC) issued a statement² to remind investors of the risks associated with VA platforms offering VA deposits, savings, earnings or staking services (collectively, VA Arrangements) claiming to offer returns to investors.

1 Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report (2018), Chapter 6 https://www.fstb.gov.hk/fsb/aml/en/doc/hk-risk-assessment-report_e.pdf

2 <https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/Statement-on-virtual-asset-arrangements-claiming-to-offer-returns-to-investors>

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The SFC observed that VAs deposited by investors may be on-lent by the platforms to borrowers on other platforms or decentralised lending protocols, or used in investment or other activities. The SFC warned investors that they may suffer significant or even total loss, especially in the event of fraud or collapse of a VA platform (as evident in the recent fallout of a number of VA platforms), given that VA Arrangements and a vast majority of VA platforms offering VA Arrangements are unregulated.

The SFC also warned that a VA Arrangement could amount to a collective investment scheme (CIS) under the Securities and Futures Ordinance, if the participating investors do not have day-to-day control over the management of their VAs, and the VAs are pooled and/or managed as a whole by the operator to generate returns for investors. It is an offence to issue an unauthorised advertisement that is an invitation to acquire an interest in a CIS or for a person to carry on a business of marketing or distributing interests in a CIS in Hong Kong or targeting Hong Kong investors without an SFC licence, unless an exemption applies. The SFC has stressed that it will take robust enforcement action promptly to safeguard investors' interests.

Latest updates on the new VASP licensing regime

On 16 December 2022, amendments³ to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO) were gazetted, following review by the Bills Committee⁴ and the subsequent passing of the amendments by the Legislative Council.

The amendments provide for a new VASP licensing regime and other anti-money laundering and counter-terrorist financing regulatory requirements.

The commencement of the AMLO provisions regarding the VASP licensing requirements and transitional arrangements has been postponed by three months to **1 June 2023**. This is to allow the Administration and

the SFC more time to work out the implementation details, including a consultation by the SFC on the VASP regulatory requirements, and more time for VASPs to make preparations.

The key dates under the new transitional arrangements are as follows:

- **1 June 2023 – New commencement date**

The provisions regarding the VASP licensing requirements and transitional arrangements take effect.

- **1 June 2023 to 29 February 2024 – Application period for deemed licensed status**

Corporations

- A corporation that has been providing a VA service (currently limited to operating a VA exchange) in Hong Kong immediately before 1 June 2023 will be deemed to be a licensed VASP after the first 12 months of the VASP licensing regime (after 1 June 2024) if on or before 29 February 2024 it makes an application to be licensed by the SFC (the application must be acknowledged in writing by the SFC and the SFC must not have issued a “rejection notice” and decided to commence the deemed withdrawal procedure in respect of the application) and gives the SFC a confirmation that: (i) it has been operating a VA exchange in Hong Kong immediately before 1 June 2023; and (ii) it will comply with (and has arrangements in place to ensure compliance with) the regulatory requirements applicable to a licensed VASP.

Deemed licensing will end on the day

3 Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Ordinance 2022 – <https://www.legco.gov.hk/yr2022/english/ord/2022ord015-e.pdf>

4 <https://www.legco.gov.hk/yr2022/english/bc/bc05/reports/bc0520221207cb1-855-e.pdf>

on which one of the following events happens (whichever happens first): (i) the corporation's application is withdrawn; (ii) a refusal of the corporation's application takes effect; and (iii) a licence is granted to the corporation.

- o Whether the carrying on of the business of providing a VA service will be regarded as taking place in Hong Kong will depend on the facts and circumstances. Relevant factors which may be considered by the SFC include whether the corporation is incorporated, registered or has a physical office in Hong Kong, whether the corporation's key personnel (such as those responsible for the operation of the trading system) are based in Hong Kong and whether the hardware for the trading system is located in Hong Kong.

Licensed representatives

- o Similar deeming provisions apply to individual representatives of VASPs. An individual applying to the SFC to be a licensed representative must be in Hong

Kong and operating a VA exchange in Hong Kong on behalf of the corporate applicant at the time of the individual's application.

Responsible officers

- o Similar deeming provisions also apply to individual responsible officers of VASPs. An individual applying to be a responsible officer must be in Hong Kong and operating a VA exchange in Hong Kong on behalf of the corporate application immediately before 1 June 2023.

- **31 May 2024 – End of closing-down period**

- o VASPs operating a VA exchange in Hong Kong that have not applied to the SFC for a licence on or before 29 February 2024 and VASP licence applicants that have been issued a rejection notice will be required to close down their VA exchange business in Hong Kong by 31 May 2024 or within three months upon the issuance of the rejection notice (whichever is later).