The Hong Kong Chartered Governance Institute

Submission

Financial Services and the Treasury Bureau (FSTB)

Public Consultation on Legislative Proposals To Regulate Over-the-Counter Trading of Virtual Assets

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Public Consultation on Legislative Proposals to Regulate Over-the-Counter Trading of Virtual Assets

[Unless the context requires otherwise, the terms and expressions used in this submission shall have the meanings set out under the Consultation Paper.]

About HKCGI

The Hong Kong Chartered Governance Institute (HKCGI), formerly known as The Hong Kong Institute of Chartered Secretaries (HKICS), is the only qualifying institution in Chinese mainland and Hong Kong for the internationally recognised Chartered Secretary and Chartered Governance Professional qualifications.

With 75 years of history and as the Hong Kong/China Division of The Chartered Governance Institute (CGI), the Institute's reach and professional recognition extends to all of CGI's nine divisions, with about 40,000 members and students worldwide. HKCGI is one of the fastest growing divisions of CGI, with a current membership of over 7,200, 300 graduates and 2,300 students with significant representations within listed companies and other cross-industry governance functions.

Believing that better governance leads to a better future, HKCGI's mission is to promote good governance in an increasingly complex world and to advance leadership in the effective governance and efficient administration of commerce, industry and public affairs. As recognised thought leaders in our field, the Institute educates and advocates for the highest standards in governance and promotes an expansive approach that considers all stakeholders' interests.

General Support

From the applied governance perspective, we support the legislative proposals to carry out the Government's Policy Statement to develop the VA sector and FATF Recommendation 15 to expand the regulatory oversight to encompass VA OTC trading.

Q1: Do you agree that the regulation of VA activities should be widened to cover OTC trading of VA?

The recent proposal to amend AMLO reflects a proactive stance to address emerging risks within the VA sector. By extending regulation to include OTC trading, from the applied governance perspective, the vulnerabilities can effectively be mitigated in this market segment where fraudulent activities exist. These regulatory measures are essential for enhancing investor protection, safeguarding market integrity, and bolstering public confidence in VA trading platforms. Furthermore, aligning regulatory frameworks with international standards, such as those established by FATF, is imperative to ensure that Hong Kong remains competitive in the global VA landscape while upholding robust anti-money laundering and counter-terrorist financing measures.

Q2: Do you agree that we should observe the "same activity, same risks, same regulation" principle in drawing up a new regulatory framework for VA OTC services, incorporating AML/CTF requirements in accordance with international standards while ensuring sufficient investor protection?

We agree with the "same activity, same risks, same regulation" principle when designing a comprehensive regulatory framework for VA OTC services. By applying consistent regulatory standards across all facets of the VA ecosystem, risks can be mitigated to ensure a level playing field for market participants in good governance. Also, the proposed regulatory framework, which incorporates AML/CFT requirements in line with international standards, underscores Hong Kong's commitment to combating financial crime and upholding the integrity of its financial system. Moreover, integrating robust investor protection measures within the regulatory framework is imperative to safeguard the interests of retail investors who may be susceptible to fraudulent schemes in the VA OTC market. Hong Kong can establish itself as a reputable jurisdiction for VA trading while maintaining the highest regulatory compliance and investor protection standards.

Q3: Do you agree with the proposed scope and format of VA OTC services to be regulated and that operators of VA OTC services who provide temporary custody/escrow service as part of the transaction process should be brought within the regulatory framework?

We agree with the proposed scope and format of regulating VA OTC. By requiring any person operating a VA OTC business in Hong Kong to obtain a license issued by the CCE, subject to meeting a fit and proper test and other regulatory requirements, the proposed regulatory framework will enhance accountability and mitigate risks associated with VA trading activities. Furthermore, it is necessary to consider operators of VA OTC services who provide temporary custody/escrow services as part of the transaction process. While facilitating transactions, these ancillary services may introduce additional operational risks and investor protection concerns. Therefore, bringing such operators within the regulatory framework is prudent to ensure comprehensive oversight and mitigate potential risks associated with custody and escrow services.

Q4: Do you agree that a license applicant must have a local nexus and suitable premises/relevant local addresses for CCE's effective supervision and monitoring?

We agree that a license applicant must have a local nexus for effective supervision and monitoring by the CCE. The requirement for locally incorporated companies or those registered under the Companies Ordinance (Cap. 622) ensures that license applicants have a tangible connection to Hong Kong's regulatory framework, enhancing the jurisdiction's ability to enforce compliance and mitigate risks effectively. The stipulation for identifying suitable premises for operation, including provisions for brick-and-mortar and digital platforms accessible to local management offices and designated addresses for correspondence and record storage, enables regulatory authorities to conduct inspections, investigations, and audits more efficiently.

In assessing the fitness and propriety of license applicants, considering factors such as past criminal convictions, bankruptcy or liquidation proceedings, and compliance history with AML/CTF requirements is crucial. These criteria ensure that only reputable and trustworthy entities are granted licenses to operate in the VA OTC market, thereby safeguarding the interests of investors and maintaining the integrity of the financial system.

We further submit that, as with the redomiciliation regime, companies must have the service of a company secretary, and we propose specifically our members as 'professional company secretaries practising in Hong Kong' as defined under the Companies Ordinance to be a requirement to ensure good governance.

Q5: Do you agree that VA OTC licensees should only be allowed to provide VA-fiat (and vice versa) spot trading services and subsequent remittance of exchange proceeds on specified conditions?

We agree that VA OTC licensees should be restricted to providing VA-fiat spot trading services exclusively, with the subsequent remittance of exchange proceeds subject to specified conditions. This approach aligns with the overarching objective of mitigating money laundering and terrorist financing risks associated with VAs while ensuring regulatory compliance and investor protection. By focusing on spot trading activities between VAs and fiat currencies, the regulatory framework can effectively address the inherent vulnerabilities of the VA OTC market, particularly with illicit financial activities. Additionally, imposing stringent conditions on the remittance of exchange proceeds enhances transparency and accountability, thereby bolstering the financial system's integrity.

Q6: Do you agree that VA OTC licensees should only be allowed to offer services with respect to tokens accessible to retail investors on at least one SFC-licensed VATP or stablecoin issued by issuers licensed by the HKMA?

We agree that VA OTC licensees should be limited to offering services exclusively for tokens accessible to retail investors on at least one of the SFC's licensed VATPs or stablecoins issued by issuers licensed by the HKMA. This restriction ensures that only tokens subject to proper approval procedures and regulatory oversight are traded within the VA OTC market, thereby minimizing regulatory arbitrage and safeguarding investor interests. The proposed approach promotes market integrity and investor confidence in VA trading activities by focusing on tokens with established regulatory frameworks.

Q7: Should other regulatory requirements be added to mitigate the potential ML/TF and fraud risks of VA OTC services?

We have identified the need for VA OTC operators to have the services of a professional company secretary practising in Hong Kong. We have no other particular issues, but as VA regulations evolve, the regulatory regime should be reviewed from time to time to ensure that it is in line with international developments and emerging market risks and mitigation mechanisms. Further, at some stage, it might be considered for the regulators, SFC, HKMA, and CCE, to form an office for coordinated regulations, intelligence sharing, and consistent regulatory enforcement outcomes.

Q8: Do you agree that a VA OTC license should be renewed biennially?

We agree that a biennial renewal period for VA OTC licenses is appropriate. The rapidly evolving landscape of the VA market necessitates regular reviews of license holders' competence and capacity to ensure proper business conduct and regulatory compliance. A biennial renewal period allows for periodic assessments of licensee eligibility and adherence to regulatory requirements, thereby promoting continuous oversight and accountability. Additionally, this approach balances regulatory scrutiny and administrative burden, ensuring that VA OTC operators uphold the highest integrity and investor protection standards while facilitating regulatory compliance.

Q9: In respect of the transitional arrangement, do you prefer Option 1 or Option 2, and why?

We submit that much depends on whether the CCE can comply with licensing requirements within six months. If so, Option 1 is preferable. If not, Option 2 allows the CCE some leeway to licence based on the reservation that any extension of time could be revoked and/or reconsidered.

Q10: Do you agree with the exemption arrangement?

We agree as the proposed exemption recognizes that entities such as VATPs, licensed corporations, and authorized institutions are already subject to robust regulatory oversight under existing regimes, including AMLO, SFO and BO. These entities are supervised by regulatory authorities such as SFC and HKMA, ensuring compliance with stringent regulatory requirements. Also, stablecoin issuers, when licensed under a dedicated regime, would already be subject to stringent regulatory requirements.

Q11: Do you agree that, to protect the public, unlicensed entities should not be allowed to actively market a regulated VA OTC service to the public of Hong Kong?

We agree that unlicensed entities should not be allowed to actively market a regulated VA OTC service to the public of Hong Kong. This prohibition is essential to safeguard investors from potential risks associated with unregulated VA OTC services, including but not limited to money laundering, terrorist financing, fraud, and market manipulation.

Q12: Do you agree that CCE should be provided with the proposed powers?

We agree that the powers outlined, including the authority to supervise AML/CTF conduct, conduct routine inspections, investigate suspected non-compliances, and impose disciplinary sanctions, are crucial for ensuring compliance with statutory and regulatory requirements under the new regulatory regime for VA OTC services. Empowering CCE with these powers enables effective enforcement of the regulatory framework, thereby enhancing market integrity and investor protection. Additionally, granting CCE the authority to obtain information from relevant authorities, such as the SFC and HKMA, facilitates collaboration and information sharing, strengthening the effectiveness of regulatory oversight.

Q13: Do you agree that the proposed penalty level for carrying out unlicensed VA OTC services will be sufficient to achieve the necessary deterrent effect?

We agree that the proposed penalty level will be sufficient to achieve the deterrent effect. The proposed penalty level of a fine of $1 million and imprisonment for two years upon conviction on indictment aligns with similar penalties outlined in AMLO. These penalties convey the severity of the offence and are likely to be a significant deterrent against unlicensed VA OTC activities.

Q14: Do you agree with the proposed sanctions, which are comparable to those under the existing regulatory regimes for VATPs and MSOs?

We agree with the proposed sanctions, comparable to those under the existing regulatory regimes for VATPs and MSOs. By aligning penalties for unlicensed VA OTC services with those for other regulated activities, such as VATPs and MSOs, the regulatory framework maintains coherence and promotes adherence to regulatory standards.

Q15: Do you agree that the purview of the Anti-Money Laundering and Counter-Terrorist Financing Review Tribunal should be expanded to hear the appeals from VA OTC licensees against the future decisions of CCE?

We agree that expanding the scope of the Anti-Money Laundering and Counter-Terrorist Financing Review Tribunal's reviewable decisions to cover appeals against the decisions made by the CCE in implementing the new VA OTC licensing regime is an appropriate proposal. Also, by allowing appeals to be heard by the Tribunal, VA OTC licensees have recourse to an independent body specialized in reviewing decisions related to anti-money laundering and counter-terrorist financing measures. This enhances transparency, accountability, and due process in regulatory enforcement within the virtual asset sector.

If there are any questions, please feel free to reach out to Ellie Pang FCG HKFCG(PE), Chief Executive, HKCGI or Mohan Datwani FCG HKFCG(PE), Deputy Chief Executive, HKCGI at 2881 6177 or research@hkcgi.org.hk.

Yours sincerely,

For and on behalf of
The Hong Kong Chartered Governance Institute

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