

Hong Kong licensing regime for virtual asset trading platforms comes into force

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On June 1, 2023, Hong Kong's licensing regime for virtual asset trading platforms came into force, following the SFC's Consultation Conclusions published on May 23, 2023 setting out the finalised regulatory requirements for licensed virtual asset trading platforms. This client update identifies key aspects of the new licensing regime and the Consultation Conclusions.

Introduction

On May 23, 2023, the Hong Kong Securities and Futures Commission (SFC) published its [Consultation Conclusions on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators Licensed by the SFC](#) (Consultation Conclusions), after a public consultation period which ended on March 31, 2023. The licensing regime and regulatory requirements came into force on June 1, 2023.

While the SFC did acknowledge suggestions and comments from the industry on various aspects of the consultation, the SFC continued to adopt a conservative approach to regulation as in its consultation paper.

Key aspects

1. Retail trading

The SFC has confirmed that it will allow licenced virtual asset trading platforms (VATPs) to provide their services for non-security tokens to retail investors, subject to compliance with a range of investor protection measures covering onboarding, governance, disclosure and token due diligence and admission.

As noted in our [previous client update](#), the SFC set out non-exhaustive general token admission criteria that VATP operators must consider in performing due diligence on each virtual asset (VA) for admission for trading. This has been further refined in the Consultation Conclusions to be more principles-based and the SFC will publish further guidance in FAQs. The main changes are:

- The SFC will only require VATP operators to consider the regulatory status of the VA in Hong Kong, instead of in each jurisdiction in which the VATP operator provides trading services.
- Acknowledging the potentially significant costs, the SFC removed the requirement for VATP operators to obtain legal opinions confirming that each VA would not amount to a security token. However, the SFC may still require legal opinions in respect of specific VAs on a case-by-case basis as part of the approval process.
- The SFC has clarified that, in relation to its “eligible large-cap VA” requirement, inclusion in two acceptable indices operates as a minimum criterion for a particular VA to be offered to retail investors. With respect to the indices, the SFC added requirements that (i) at least one of the two index providers must comply with the IOSCO Principles for Financial Benchmarks, in addition to the SFC's initial requirement of having experience in publishing indices for the conventional securities market, and (ii) the two index providers should also be independent of the VA issuer and the

VATP operator.

The SFC clarified that it will not admit stablecoins for retail trading prior to stablecoins being subject to regulation in Hong Kong, which is expected to be implemented in 2023/2024.

2. VA derivatives

The SFC has reiterated its awareness of the importance of VA derivatives to institutional investors, and will conduct a separate review in due course.

3. Prohibited activities

The SFC has decided to prohibit certain activities by VATPs, with the following changes and clarifications:

- The SFC clarified that it will allow affiliates of a VATP to trade on platforms other than that operated by the VATP itself.
- Financial accommodation by the VATP operator (or corporations within the same group of companies) is allowed for off-platform transactions by institutional investors for VAs not issued by the VATP operator or the investor (or corporations within their respective group of companies).

The SFC continues to prohibit VATP from making any arrangements with the effect of generating returns for clients using client VAs (e.g. staking products).

4. Custody of client assets

The SFC acknowledged that there may be third-party custodians with extensive technical expertise. However, the SFC would not accept custody of client assets by third-party custodians. Assets must be held by a wholly owned subsidiary of a licenced VATP.

Seeds and private keys (and their backups) must be stored securely in Hong Kong with appropriate certification (e.g. Hardware Security Module). The SFC has expressed an openness to consider allowing licenced VATPs to adopt different custody solutions when the industry reaches a consensus on their security and appropriate certifications for the solutions emerge.

5. Insurance and compensation arrangement

The finalised VATP Guidelines require VATP operators to have in place a compensation arrangement that covers 50% of client virtual assets held in cold storage and 100% of client virtual assets in hot and other storages held by associated entities. The SFC has also maintained its requirement that at least 98% of client virtual assets should be held in cold storage.

The compensation arrangement should include any or a combination of:

- third-party insurance;
- either funds (held in the form of a demand deposit or time deposit which will mature in six months or less) or VAs (which are the same as the client VAs covered under the compensation arrangement) of the VATP operator or any corporation within the same group of companies as the VATP operator which are set aside on trust and designated for such a purpose; and
- bank guarantees provided by an authorized financial institution in Hong Kong.

6. AML/CFT requirements

As discussed in our [previous client update](#), VA-specific AML/CFT requirements are set out in the new Chapter 12 of the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Service Providers), covering areas such as additional customer due diligence requirements, the “travel rule,”¹ VA transfer counterparty due diligence, VA transfers involving unhosted wallets, cross-border correspondent relationships and screening of VA transactions and associated wallet addresses.

The SFC recognised that it may take time to develop systems to facilitate the submission of required information “immediately” per the requirements of the travel rule, and therefore has indicated that it will be acceptable for VATPs to submit the required information “as soon as practicable” instead. This interim measure will remain in effect until January 1, 2024.

Resources
Crypto Regulation Hub

Visit our Crypto Regulation Hub for links to congressional proposals related to the regulation of crypto assets and other helpful materials.

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¹ Under the travel rule for VA transfers, licensed VATPs are required to (i) when acting as the ordering institution, obtain, hold and submit required information about the originator and recipient to the beneficiary institution immediately and securely; and (ii) when acting as the beneficiary institution, obtain from the ordering institution and hold required information.