

Hong Kong: New virtual asset OTC trading regulatory regime

In brief

On 8 February 2024, the Financial Services and the Treasury Bureau of Hong Kong (FSTB) released a public consultation (**Consultation**) on legislative proposals to introduce a licensing regime (**Proposed Regime**) for providers of over-the-counter (OTC) trading services of virtual assets (VA). The Proposed Regime will be regulated by the Commissioner of Customs and Excise (CCE). In view of recent fraud cases involving VA OTC operators and the large scale of VA OTC operators in Hong Kong, the Hong Kong Special Administrative Region Government (Hong Kong Government) sees the need to regulate. The Consultation represents the latest step in the city to further enhance the VA regulatory framework as outlined by the Hong Kong Government in its 2022 Policy Statement on Development of VA in Hong Kong.¹ The consultation will end on 12 April 2024. We discuss the Consultation in more detail below.

What VA OTC business is regulated under the Proposed Regime?

The Proposed Regime will be regulated under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (AMLO). The "VA OTC business" that is proposed to be regulated will be defined as:

- a. by way of business, provision of service of spot trade of any VA;
- b. irrespective of whether the service is provided through a physical outlet (i.e., including ATMs) or other (e.g., digital) platforms; and
- c. explicitly excluding the operation of a Virtual Asset Trading Platform (VATP)² as already covered under the VATP licensing regime regulated by the Hong Kong Securities and Futures Commission (SFC).

The scope of "VA" products covered will be the same as regulated in the VATP licensing regime, as set out in section 53ZRA of the AMLO, which refers to a cryptographically secured digital representation of value that possesses a range of features (including being expressed as a unit of account or a store of economic value, used for payment for goods or services, discharge of a debt etc.).

The Proposed Regime does not intend to cover peer-to-peer trading of VA between individuals unless the trade forms the business activity of either party. Also, the Proposed Regime will not cover a person who is not a party to the contract or binding transaction (e.g., online platforms/online applications, instant messaging systems whereby the operator simply maintains a platform for posting or facilitating peer-to-peer trades).

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¹ https://gia.info.gov.hk/general/202210/31/P2022103000454_404805_1_1667173469522.pdf

² As defined in Schedule 3B to the AMLO.



Who requires a licence under the New Regime?

The Proposed Regime will impose licensing requirements on any person operating a VA OTC business in Hong Kong, or actively marketing (whether in Hong Kong or from a place outside Hong Kong)³ the provision of VA OTC services to the Hong Kong public.

It is proposed that the following persons will be exempted from the licensing requirements:

- VATPs regulated under the AMLO;
- licensed corporations regulated by the SFC under the Securities and Futures Ordinance (Cap. 571);
- authorised institutions regulated by the Hong Kong Monetary Authority (HKMA) under the Banking Ordinance (Cap. 155);
- licensed stablecoin issuers regulated by the HKMA under the proposed new laws and regulations.⁴

There will be a prohibition against any person knowingly issuing an advertisement relating to an unlicensed person's provision of VA OTC services.

The FSTB is also seeking views whether temporary custody/escrow services provided by VA OTC operators should also be covered by the Proposed Regime and whether there should be dedicated regulatory requirements for such services.

Key Licensing Criteria and Conditions

Place of incorporation?

Applicants will need to be:

- a Hong Kong incorporated company with a permanent place of business in Hong Kong, or
- a company incorporated elsewhere but registered in Hong Kong under the Companies Ordinance (Cap. 622).

Business premises?

Suitable premises will need to be identified for operation of the VA OTC services.

For digital VA OTC operators, the requirements will include providing information on:

- the address of the local management office in Hong Kong;
- the correspondence address; and
- the place for local storage of books and records in Hong Kong.

Fit and proper test?

The CCE will consider all relevant matters relating to fitness and propriety, including whether the applicant (or any of its directors or ultimate owners) has any convictions involving fraud, corruption or dishonesty and failure to comply with anti-money laundering or counter-terrorist financing (AML/CFT) or other applicable requirements.

Permitted activities and non-permitted activities?

VA OTC licensees ("Licensees") will only be permitted to perform spot trades of VA for any money or vice versa.

The Licensees will not be permitted to do the following:

- conversion of one VA to another VA;
- provision of services on remittance of fiat money unless the Licensee has obtained a money service operator licence under the AMLO;

³ Including actively marketing, whether in Hong Kong or from a place outside Hong Kong, to the Hong Kong public, a regulated VA OTC service or any service which would constitute a regulated VA OTC service if it is conducted in Hong Kong.

⁴ See "Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong – Consultation Paper" jointly issued by FSTB and the HKMA in December 2023. Please refer to our previous [alert](#).



- VA advisory or referral services, offering of VA derivatives or other financial products; or
- custody/escrow service of client's VA (unless it is temporary in nature and is an indispensable part of the transaction process).

Eligible VA to be dealt with?

Licensees may provide services in respect of the following tokens only:

- tokens that may be accessed by retail investors on at least one SFC-licensed VATP; and
- stablecoins issued by issuers licensed by the HKMA upon implementation of the proposed licensing regime for stablecoin issuers.

Limitations on third party transfers?

Licensees will need to provide the full list of wallets to the CCE that are used in their operations and register the list with the CCE. Licensees will only be allowed to transfer VA from their registered wallets to a client wallet for which the client can provide proof of ownership and/or control.

Other regulatory requirements?

Licensees will need to observe the AML/CTF requirements in Schedule 2 of the AMLO. The other proposed regulatory requirements on the Licensee include:

- a. Compliance officer (CO)/Money Laundering Reporting officer (MLRO) – appointing a competent CO and a MLRO.
- b. Competence/knowledge and experience – having a proper corporate governance structure consisting of personnel with necessary knowledge and experience with VA.
- c. Soundness of business - operating the business in a prudent and sound manner to ensure clients' and the public's interests are not adversely impacted.⁵
- d. Conduct - acting honestly, fairly, with due skill, care and diligence in the best interests of its clients and the integrity of the market.
- e. Risk management - having in place appropriate risk management policies and procedures managing ML/TF⁶, cybersecurity and other risks arising from its activities commensurate with the scale and complexity of its business.
- f. Record keeping - maintaining proper records of transactions and fund flows.

Licence Duration/Transition arrangements?

Successful applicants will be granted a licence of two years duration, renewable for two years upon application and to the satisfaction of the CCE.

The Consultation includes two potential transition arrangements for comment. These are:

Option 1 – No deeming arrangement. A transitional period of six months will apply (**Transitional Period**). Pre-existing VA OTC service providers will be allowed to continue operations until the end of the Transitional Period, on condition they submit a licence application to the CCE within the first three months (**Submission Deadline**). At the end of the Transitional Period, all VA OTC service providers have to be licensed to carry out any regulated activity. Pre-existing VA OTC service providers that do not submit a licence application by the Submission Deadline will need to close down their business in an orderly manner by the end of the fourth month of the commencement of the Transitional Period.

Option 2 – With deeming arrangement. Pre-existing VA OTC service providers will be allowed to continue operations until the end of the Transitional Period on condition that they submit a licence application by the Submission Deadline. Applicants that are able to meet the requirements specified by the CCE, will be granted a "deemed licence" enabling them to continue operation beyond the Transitional Period until a final determination of the licence application is made by the CCE.

⁵ Among others, a licensee needs to submit an accurate and up-to-date staff list for the CCE's retention.

⁶ Among others, a licensee has to subscribe for AML tools to carry out fund tracing functions.



Consultation Deadline

The deadline for submissions in response to the Consultation is 12 April 2024.

Going Forward

The Consultation represents an important opportunity to help shape the VA OTC regulatory framework going forward. If you have any questions on how the proposed changes may impact your business and activities, or in the event that you would like to discuss a potential submission, please liaise with your usual contact at Baker McKenzie or the lawyers listed in this client alert.

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