

New Regulatory Regime for Virtual Asset Trading Platform Operators Rolled Out

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Introduction

This explanatory note intends to provide a summary of legal landscape, licensing requirements and application procedures for virtual asset service providers (“**VASP**”) licensed by the Securities and Futures Commission (the “**SFC**”).

Save for all qualified pre-existing virtual asset trading platforms during the transitional arrangements (i.e. between 1 June 2023 and 31 May 2024), VASP carrying on business without a license shall be in breach of the licensing requirements of VASP regime under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615 of the Laws of Hong Kong) (the “**AMLO**”) which will come into effect on 1 June 2023 (the “**AMLO VASP Regime**”).

Dual Licenses Regime

Upon commencement of the AMLO VASP Regime, the SFC will regulate the trading of:-

- (i) security tokens by VASP under the existing regime (the “**SFO VASP Regime**”) (i.e. VASP licensed to carry on Type 1 (i.e. dealing in securities) and Type 7 (i.e. providing automated trading services) regulated activities under section 116 of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (the “**SFO**”)); and
- (ii) non-security tokens by VASP licensed under the AMLO VASP Regime.

Consultation Paper

The SFC has recently published the “Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators Licensed by the Securities and Futures Commission” (the “**Consultation Paper**”) and the proposed “Guidelines for Virtual Asset Trading Platform Operators” (the “**Guidelines**”) which listed out the licensing requirements and application procedures for VASP licenses under the SFO VASP Regime and the AMLO VASP Regime.



Licensing Requirements

Fitness and Properness Requirements¹: When assessing fitness and properness, the SFC shall have regard to the matters below:-

- (i) Financial status or solvency;
- (ii) Educational or other qualifications or experience;
- (iii) Ability to carry on the relevant activities competently, honestly and fairly; and
- (iv) Reputation, character, reliability and financial integrity.

The SFC may also take into consideration the matters under section 129(2) of the SFO and section 53ZRJ(2) of the AMLO in considering whether a person is fit and proper.

In the Guidelines, the SFC has also set out the criteria for assessing the fitness and properness.

Competence Requirements: The competence requirements stem from the fitness and properness requirements. In the Guidelines, the SFC sets out key high-level competence requirements of corporation and individual.

(i) For Corporation

The following non-exhaustive examples illustrate key elements that the SFC will consider for assessing the competence of a corporation:-

- (a) Business (e.g. information about the proposed business line, clientele and products);
- (b) Corporate governance (e.g. shareholding and organizational charts);
- (c) Staff competence (e.g. policies and procedures to ensure that staff are suitably qualified);
- (d) Internal controls (e.g. adequate internal control system);
- (e) Operational review (e.g. a function for reviewing the internal control systems);
- (f) Risk management (e.g. risk management policies and procedures); and
- (g) Compliance (e.g. compliance policies and procedures).

(ii) For Individual

Individual (e.g. license representative (“**LR**”) or responsible officer (“**RO**”)) has to satisfy the SFC that he:-

- (a) has necessary academic, professional or industry qualifications;
- (b) is knowledgeable about virtual assets and the virtual asset market;
- (c) has good understanding of the regulatory framework (including laws, regulations and associated codes); and
- (d) is familiar with the ethical standards expected of a financial practitioner.²

In short, the competent requirements align with those applicable to LR and RO accredited under the other regulated activities of the SFO.

¹ Where the person is a corporation, those matters must be considered in respect of the corporation and any of its officers.

² For example, Ethics in Practice - A Practicable Guide for Financial Practitioners published jointly by the SFC, ICAC and other organizations.

External Assessment Report

Insofar application procedures are relevant, the applicant is, amongst others, required to engage an external assessor to assess its business going forward, and submit the assessor's reports to the SFC:-

- (i) when submitting the licence application ("**Phase 1 Report**"); and
- (ii) after approval-in-principle to the application is granted by the SFC ("**Phase 2 Report**").

Phase 1 Report: It should be compiled in a suggested format to include the prescribed items (e.g. executive summary; expertise, experience and track records of the external assessors(s); scope/areas of the assessment and etc.) with a focus on key areas which include:-

- (i) Governance and staffing;
- (ii) Token admission;
- (iii) Custody of virtual assets;
- (iv) Know-Your-Clients;
- (v) Anti-Money Laundering/Counter-Financing of Terrorism;
- (vi) Market surveillance;
- (vii) Risk management; and
- (viii) Cybersecurity.



The assessor should review and assess whether the VASP's policies and procedures are clearly written and in compliance with the applicable legal and regulatory requirements, and, in particular, the Guidelines and the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations and SFC-licensed Virtual Asset Services Providers).

Phase 2 Report: It should be the assessor's assessment of the implementation and effectiveness of the actual adoption of the planned policies, procedures, systems and controls. The SFC will grant final approval only if it is satisfied with the findings of the Phase 2 Report.

