

# SFC issues Consultation Conclusions on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators

## Background

On 23 May 2023, the Securities and Futures Commission ('SFC') published the [Consultation Conclusions](#) on the proposed licensing regime for virtual asset ('VA') trading platform operators ('VATP Licensing Regime') ('**Consultation Conclusions**'). The Consultation Conclusions follows feedback from market participants in relation to the questions posed by the SFC in its public consultation on the VATP Licensing Regime issued on 20 February 2023 ('**Consultation Paper**'). For a review of the Consultation Paper, please refer to our [News Flash](#) issued in February 2023. The Consultation Conclusions also includes the further revised draft guidelines in final form – (1) Guidelines for VATPs ('**Revised VATP Guidelines**'), (2) Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (for Licensed Corporations and SFC-licensed VA Service Providers) ('**Revised AML Guideline for LCs and VASPs**') and (3) Prevention of Money Laundering and Terrorist Financing Guideline issued by the SFC for Associated Entities of LCs and SFC-licensed VASPs.

In this News Flash, we provide a summary of the Consultation Conclusions and share some insights into what it means for market participants.

## 1. Retail access to certain VAs on Licensed VATPs

### Retail access


In the Consultation Conclusions, the SFC confirmed the proposed arrangement in the Consultation Paper to allow retail investors to access trading services of 'non-securities' VAs provided by licensed VATPs provided that certain onboarding and governance requirements, token due diligence ('DD') and admission criteria and disclosure obligations are duly complied with by the licensed VATPs.

### Onboarding requirements

In the Consultation Paper, the SFC had proposed to require VATPs to assess a client's risk tolerance level and risk profile and set a limit for each client to ensure that the client's exposure to VA is reasonable with reference to the client's financial situation and personal circumstances, as determined by the VATP.

### No exemptions

Although some respondents suggested that various exemptions to the onboarding requirements of retail investors should be allowed, the SFC refused to relax such requirements in the Consultation Conclusions mainly because the terms, features and risks of VAs are unlikely to be understood by a retail investor.

A wide-angle photograph of the Hong Kong skyline, featuring numerous skyscrapers and the Victoria Harbour in the foreground. The image serves as a background for the top half of the page.

As to whether individual professional investors should be exempt from the onboarding requirements, the SFC also insisted that they should be subjected to the same requirements as retail investors.

### Knowledge of retail investors

In addition to the proposed onboarding requirements in the Consultation Paper, the SFC revised the VATP Guidelines to incorporate the requirement for VATPs to conduct a holistic assessment of an investor's understanding of the nature and risks of VAs, which could include:

- an assessment of VA training or courses that the investor has previously attended;
- the investor's current or previous work experience related to VAs; and
- the investor's prior trading experience in VAs.

The SFC will also revise guidelines for other intermediaries engaging in VA-related activities accordingly to ensure alignment of all intermediaries.

### Exposure limits and risk tolerance levels

Although the SFC declined to specify the exposure limits for investors based on their individual financial situation and risk tolerance levels, the SFC indicated that frequently-asked questions ('**FAQs**') will be published to provide guidance on issues such as how to assess a client's risk tolerance and exposure to VAs.

## **Governance requirements**

In relation to the composition of the token admission and review committee ('**Committee**') which is required to be set up by the VATPs, the SFC clarified in the Consultation Conclusions that the Committee should at least include the corresponding managers-in-charge ('**MICs**') of the VATP overseeing (1) the key business line, (2) compliance, (3) risk management and (4) information technology. Additional FAQs on an MIC regime for VATP senior management will be issued shortly (similar to the existing regime for licensed corporations).

As for potential conflicts of interest, the SFC did not think it would be necessary to appoint independent external members to the Committee but suggested that VATPs should implement various policies and procedures to deal with conflicts, such as declarations of interests by Committee members and abstaining from considering matters in relation to those VAs in which the Committee member has an interest.

## **Disclosure requirements**

In light of the difficulty in verifying information in relation to a VA, the SFC relaxed the disclosure requirements in the Revised VATP Guidelines by:

- only requiring VATPs to ‘take all reasonable steps’ to ensure the product specific information they disclose is not false, biased, misleading or deceptive; and
- amending the list of information required to be disclosed.

## **Compliance with rules in other jurisdictions**

In the Revised VATP Guidelines, the requirement for VATPs to consider the token’s regulatory status in each jurisdiction in which the VATP provides trading services was removed. Instead, a VATP is now only required to consider the regulatory status of the VA in the Hong Kong SAR (‘HK’) according to the Consultation Conclusions.

## **Smart contract audit**

In relation to the smart contract audit requirement, the SFC clarified in the Consultation Conclusions that VATPs will only be expected to rely on an audit conducted by an independent assessor engaged by another party (for example, the issuer) where reasonable. Reference to ‘independent auditor’ in the revised VATP Guidelines was replaced with ‘independent assessor engaged by a third party’ accordingly.

On the other hand, the SFC imposed in the Revised VATP Guidelines additional requirement on VATPs to ‘exercise due skill, care and diligence in selecting and appointing an independent assessor’ to conduct a smart contract audit.

## **Submission of legal advice**

In view of the potentially significant costs, the SFC removed the proposed requirement in the Consultation Paper on VATPs to submit to the SFC written legal advice confirming that each token made available for trading by retail clients would not amount to a security token. However, the SFC warned VATPs in the Consultation Conclusions that it may request legal opinions on specific tokens in light of developments in other jurisdictions as part of the approval process.

## **Specific token admission requirements**

### IOSCO Principles and high liquidity

Noting that the reliability of the underlying data and possibility of conflicts of interest may affect an index’s integrity, the SFC now requires the index provider with experience in publishing indices for the conventional securities market to also comply with the International Organisation of Securities Commissions (‘**IOSCO**’) Principles for Financial Benchmarks. In addition, the SFC requires the two index providers to be independent of the issuer of the VA as well as of the VATP.

In the case of tokens for retail trading, the SFC also imposed an additional requirement in the Revised VATP Guidelines – that tokens must also have sufficiently high liquidity (although it remains to be seen what this means precisely).

### Lists of eligible VAs, acceptable indices or index providers

The SFC declined to publish lists of VAs eligible for retail trading, acceptable indices or index providers because the admissibility and continued eligibility of a token for trading depends on the DD conducted by a VATP.

### Stablecoins

In relation to stablecoins, the SFC confirmed again in the Consultation Conclusions that at this stage, they will not be permitted for retail trading (until such time as there are regulations in HK governing stablecoins – we expect this to be forthcoming from the HK Monetary Authority).

### **Investor protection**

Offering gifts that are tied to the trading of a specific VA will be prohibited. However, the offering of discounts on fees and charges will be allowed. Platform contracts will also not be subject to any 'cooling off' period.

## **2. Insurance / compensation arrangement**

Regarding the insurance arrangement for VATPs, the SFC had proposed in its Consultation Paper a flexible arrangement by permitting VATPs to use a combination of third-party insurance together with a compensation arrangement (such as funds).

In the Consultation Conclusions, the SFC reported that the majority of respondents were supportive of some form of insurance or compensation arrangement although there were diverse views on the appropriate level of coverage, the set up and types of assets that could form part of a compensation arrangement.

The SFC's final position is that:

- (a) client VAs held in storages other than cold storages should be covered by a compensation arrangement whereas those in cold storages will be subject to a 50% coverage threshold because of the stringent private key management and custody requirements and also noting that clients of traditional financial institutions ('**FIs**') are not fully insured against the loss of their assets;
- (b) acceptable types of assets for a compensation arrangement include relatively stable financial instruments such as bank guarantees and deposits with a maturity of 6 months or less while reserve VAs should be the same as the client VAs in order to reduce volatility risk. The assets set aside for a compensation arrangement must be set aside on trust and segregated from other assets and where these are VAs, they are to be held in cold storage by its 'associated entity' (a wholly owned subsidiary of the VATP); and
- (c) VATPs may jointly or individually establish a pool of funds to cover the loss of their client assets.





### 3. Independent custodian

In the Consultation Paper, the SFC proposed that the custodian of client VAs must be a wholly-owned subsidiary of the VATP. This received strong pushback from respondents, who, among other things, argued that third-party custodians should be permitted to safekeep client VAs given their extensive technical expertise. However, given the importance of safe custody and the fact that there is no existing regulatory regime in HK governing custodians, the SFC has insisted that this requirement should remain, as this then enables the SFC to have a direct regulatory handle over the custodian.

### 4. Trading of VA derivatives

As alluded to in the Consultation Paper, VATPs will not be allowed to offer VA derivatives at the current stage. The SFC will conduct a separate review in due course.

### 5. AML/CFT

#### Travel Rule

The SFC remained of the view that the Travel Rule is a key AML/CFT measure for VASPs and noted that other major jurisdictions have already implemented the Travel Rules. However, the SFC also acknowledged that it may take time for systems to be developed to enable the immediate submission of the required information to a beneficiary institution. As such, as an interim measure until 1 January 2024, the submission of the required information 'as soon as practicable' will be acceptable where the submission cannot be made immediately. Other Travel Rule requirements as proposed in the Revised AML Guideline for LCs and VASPs, such as ensuring secure transmission, will take effect from 1 June 2023.

In the case of unhosted wallets which may pose higher AML/CFT risks, the SFC now demands licensed VATPs to:

- (i) obtain the required information from the customer and conduct sanctions screening; and
- (ii) only accept transfers with unhosted wallets that are assessed to be reliable<sup>1</sup>.

#### VA transfer counterparty DD and additional measures

With respect to the ambiguity around the requirements on VA transfer counterparty DD, the SFC clarified that such measures should be applied using a risk-based approach, especially when screening VA transfers as an ongoing monitoring task, with paragraph 12.13 of the Revised AML Guideline for LCs and VASPs amended accordingly.

Where VA transfers are conducted with several VA transfer counterparties that belong to the same group, the licensed VATPs should take this into account while conducting DD on each of them independently to enable a more holistic view of the risks they pose.

---

<sup>1</sup> Having regard to the screening results of the VA transactions and the associated wallet addresses, as well as the assessment results of the ownership or control of the unhosted wallet.

## **Returning VAs**

In relation to concerns about returning VAs, the SFC clarified that a licensed VATP should only return VAs where appropriate and when there is no suspicion of ML/TF to the account of the ordering institution, rather than to the originator's account, as reflected in the additional guidance provided in paragraph 12.11.22 of the Revised AML Guideline for LCs and VASPs.

## **VA transfers via unhosted wallets**

For measures to mitigate and ML/TF risks associated with VA transfers to or from a hosted wallet, the suggested non-exhaustive risk-based measures set out in paragraph 12.14.3 of the AML Guideline for LCs and VASPs in the Consultation Paper has now become mandatory.

Paragraph 12.14.3 of the AML Guideline for LCs and VASPs was also amended to impose additional requirements on VATPs to 'ascertain the ownership or control of the unhosted wallet on a periodic and risk-sensitive basis' where a VA transfer is conducted via an unhosted wallet which has been whitelisted, particularly when it becomes aware of any heightened ML/TF risks from the ongoing monitoring of the transactions.

## **Occasional transactions**

To clarify whether and how the thresholds for customer DD apply to licensed VATPs before carrying out any occasional transaction, the SFC amended paragraphs 12.3 of the AML Guideline for LCs and VASPs to prohibit licensed VATPs from carrying out occasional transactions as they are required to establish a business relationship with all customers pursuant to the VATP Guidelines.

## **Cross-border correspondent relationships**

As to whether cross-border correspondent relationships cover VA transfers, the SFC clarified in the Consultation Conclusions that such relationships apply to a licensed VATP when it provides services in the course of providing a VA service as defined in section 53ZR of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) ('AMLO') (i.e., operating a VA exchange) to a VASP or FI located outside HK which acts for its underlying customers. Such relationship does not cover VA transfers with these institutions but covers execution of VA trading transactions for these institutions.

In addition, a new paragraph 12.6.5 has been added to the AML Guideline for LCs and VASPs to clarify that licensed VATPs are required to conduct ongoing monitoring of VA transactions and the associated wallet addresses.

## **Screening of VA transactions and the associated wallet addresses**

To clarify that screening should be performed (i) before conducting a VA transfer, or before making the transferred VAs available to the customer; (ii) and after conducting a VA transfer on a risk-sensitive basis, a correspondence footnote has been incorporated to paragraph 12.7.3 of the AML Guideline for LCs and SFC-licensed VASPs.

## 6. External assessment report

As an ongoing requirement as set out in the Consultation Paper, a VATP must engage an external assessor to assess its business and submit to the SFC (i) a Phase 1 Assessor's Report at the time of the VATP licence application and (ii) a Phase 2 Assessor's Report after approval-in-principle is granted. Interestingly, the SFC noted that it would be acceptable for external assessors to advise on / draft policies and procedures, conduct gap analyses and advise on remediation, in addition to preparing the Phase 1 and Phase 2 reports.

## 7. Disciplinary Fining Guidelines

The fining criteria in the final form of the Disciplinary Fining Guidelines will be applicable to both VATPs licensed under the SFO and the AMLO as the activities carried out are essentially the same but for the nature of the tokens traded (securities vs non-securities).

The SFC will adopt a holistic approach and consider the facts of each case when determining which party(ies) are to be disciplined for any breach of any SFC requirement. The factors that the SFC will take into consideration include the conduct of the corporation/individual in question, the internal controls and implementation thereof.

Where the SFC decides to impose a fine, the amount of the fine will be determined taking into account the nature and seriousness of the misconduct and the seniority of the individuals involved and any remedial actions taken. Any fine will not be automatically linked with the profit gained or loss avoided as the SFC considers that this may not necessarily reflect the severity of the misconduct. Under current law, any fine should not exceed HK\$10 million or three times the profit gained or loss avoided by the regulated person, whichever is higher. It is possible for a misconduct to consist of more than one culpable act or omission in which case multiple penalties may be imposed.

## 8. What constitutes 'providing a VA service' in the AMLO

Following questions on the scope of 'providing a VA service' in the AMLO, the SFC clarified in the Consultation Conclusions that the AMLO regime will only cover VATPs which provide centralised and automated client trade matching services and ancillary custody services, like a traditional automated trading platform currently licensed under the SFO. Specifically, the scope of 'providing a VA service' does not cover VA services without an automated trading engine and ancillary custody services (such as over-the-counter VA trading and VA brokerage activities). This means that the trading/brokerage of non-securities tokens would remain a non-regulated activity under the current SFO regime.

## 9. Dual licences

The SFC reiterated that it would be prudent for a VATP to obtain licences under both the SFO and AMLO regimes, the rationale being that the features of a VA, and therefore its classification as a security vs non-security token, may change over time. This is important because if a VATP does not have these licences, and only lists non-security tokens, a regulatory breach would occur if any such token changed characteristics and into a security token.

## 10. Implementation details

There is no change to the implementation timeline for the VATP Regime (i.e. effective on 1 June 2023).

### Conclusion

The SFC's published Consultation Conclusions demonstrate a practical but disciplined approach in response to the consultation process, especially considering the significant number of written submissions and the tight deadline for implementing the finalised VATP Regime. It would appear that the SFC has chosen a conservative approach on key issues such as third-party custodians, retail token admission requirements, and investor onboarding requirements. This is understandable, given that fundamentally, the SFC is proposing to allow the retail public to access products that are essentially unregulated and have not had the benefit of scrutiny by another regulatory body. Tight regulatory controls and oversight are, therefore, to be expected.

In other areas, it would appear that the SFC has demonstrated a willingness to be more flexible – for example:

- insurance and compensation arrangements;
- reduced insurance coverage for cold wallets (to 50%);
- removing the need for a legal opinion on the securities status of retail tokens;
- lifting the blanket ban on group company VA trading; and
- modifying the Travel Rule to allow for an interim arrangement for information submission to beneficiary institutions.

These are all to be commended as a pragmatic response to the need (as expressed by many of the consultation participants) to reduce the cost/burden of regulatory compliance.

With the upcoming 1 June 2023 implementation date, the SFC has laid out a robust and comprehensive regulatory framework. While further clarification and updates are expected in the form of FAQs and Circulars, the scene is pretty much set for an exciting rollout over the coming months – one that is also eagerly anticipated (judging from the level of interest from both domestic and foreign market players). This development marks a significant step forward for the VA regulatory ecosystem in Hong Kong, and one that places Hong Kong in a prime position as the crypto hub for the APAC region.



Please reach out to us if you have any questions or queries.

## Contact us

### Tiang & Partners\*



**Gaven Cheong**  
Partner  
Tiang & Partners  
+852 2833 4993  
[gaven.cheong@tiangandpartners.com](mailto:gaven.cheong@tiangandpartners.com)

### PwC Hong Kong



**Duncan Fitzgerald**  
Partner, Financial Services  
PwC Hong Kong  
+852 2289 1190  
[duncan.fitzgerald@hk.pwc.com](mailto:duncan.fitzgerald@hk.pwc.com)



**Peter Brewin**  
Partner, Tax  
PwC Hong Kong  
+852 2289 3650  
[p.brewin@hk.pwc.com](mailto:p.brewin@hk.pwc.com)



**Michael Footman**  
Partner, Financial Services Risk and  
Regulatory Leader  
PwC Hong Kong  
+852 2289 2747  
[michael.hc.footman@hk.pwc.com](mailto:michael.hc.footman@hk.pwc.com)

\*Tiang & Partners is an independent Hong Kong law firm with a close relationship with PwC.

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors. © 2023 PwC. All rights reserved.

In this document, PwC refers to the Hong Kong member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see [www.pwc.com/structure](http://www.pwc.com/structure) for further details.

The materials contained in this document were assembled in May 2023 and were based on the law enforceable and information available at that time.